The macro-economics of social investment

The fiscal dimension

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Executive summary

The European Commission's social investment package acknowledges the importance of the social dimension of human existence for economic development, and proposes an ambitious pan-European multi-dimensional programme of co-ordinated policies by EU Member States. This is informed by its own extensive evidence of economic and social imbalances in the region, particularly in the wake of the Great Crisis after 2008. This report, however, notes that the rhetoric of a social investment-driven process of economic and social cohesion remains rooted in a narrative that questions the role of the state as an economic actor and which continues to prioritise fiscal consolidation, deficit- and debt-reduction and the privatisation of public services. Accordingly, as in the parallel European Investment Plan, the Commission places a strong emphasis on the mobilisation of private capital for investment into and delivery of public goods.

The report questions the logic of 'crowding in' private investment from a theoretical and empirical analysis of four decades of supply-sidism: declining rates of investment, weaker rates of economic growth, high levels of inequality, destructive levels of financialisation and short-termism, growing levels of monopolisation, and a dysfunctional response to the Great Crisis. Furthermore, the economic trajectory implied by private sector participation in social investment can be seen to reinforce the trend of financialisation and weaker real investment. Europe's political economies need, rather, to reduce levels of monopolistic rent-seeking and promote programmes of economic and social innovation which deliver real benefits for human welfare. The time-horizons and the comprehensive nature of social investment make collective, public responsibility for such programmes inescapable; equally, the need to underpin the public delivery of public goods democratically is urgent for the realisation of long-term social and cultural cohesion.

The report notes the negative foundations of the official concept of 'fiscal sustainability' and the virtual absence of a revenue dimension in the EU's scheme of 'fiscal governance'. The concept of 'fiscal viability' is therefore counter posed to the essentially monetarist assumptions of 'sustainability', in particular because of the longer-term, inter-generational ambitions of social investment. Fiscal viability requires the assurance that longer-term, transformative reforms are adequately resourced and not subject to arbitrary cutbacks. This in turn means both the harmonisation and upward convergence of taxation systems within the European Union, and the preparedness to use debt securities to maintain the essential continuity of support for agreed programmes of social investment.

An exposition of the extreme asymmetries of taxation systems and tax culture within the EU underscores the need for a thorough-going reform of the region's revenue-generation: reintroducing and/or enhancing the scale of progressivity in income-taxation, thus eliminating flat tax regimes from several CEECs, reducing the increasing dependence on regressive indirect taxation, raising national tax ratios to levels sufficient for both long-term structural expenditure and short-term crisis-management. Without such reforms, the EU will become increasingly powerless to combat the destructive processes of inter-state tax-competition and to resist the tax and regulatory arbitrage activities of global corporations. The need for convergence is inescapable

The second part of the report sets social investment in the context of a new paradigm of long-term 'patient capital' as the foundation for a transformative programme by an active democratic state committed to the enhancement of human capabilities and of social capital and the protection and improvement of natural capital. The nature of secular economic and technological developments and of democratically underpinned human rights demand a considerably more active role for the state as economic and social actor, in line with Wagner's Law. This has to be reflected in a radical reform of economic and, most relevantly here, fiscal governance.

The report stresses the importance of fiscal and economic multipliers, firstly noting the negative multiplier effects of austerity politics and their inadvertent but dangerous 'stunting' and 'scarring' of human development, which was evident both before and after the Great Crisis. Secondly, the positive multiplier effects of a courageous, active state are postulated, with particular reference to the need for an effective and equitable fiscal transmission process. This is linked to the earlier discussion of fiscal viability and fiscal subsidiarity and is supported by a comparison of contrasting models of fiscal distribution and equalisation among Europe's Member States. Notwithstanding the heterogeneity of Europe's states and statelets, the report concludes that a best case paradigm of fiscal governance would be characterised by the fiscal federalism and refined scheme of fiscal equalisation of Germany (but without the new constitutional straitjacket of the 'debt brake') on the one hand, and the embedded fiscal norms of the Scandinavian cluster of states.

Without a reversal of the current set of ideological and political preferences at the level of the EU and its major Member States, the laudable ambitions of a socially inclusive, solidaristic Europe will evaporate. Without the intensified involvement of the public sector, in particular at sub-national levels, and the guarantee of appropriate, adequate and predictable revenue-streams, the disillusionment of increasing sections of European societies in political and economic elites will grow, undermining the viability of the Union itself.

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This part critiques the rationale behind the European Union's 2013 social investment package. It questions the feasibility of private funding sources for core social policy programmes and identifies the danger of promoting rent-seeking behaviour as a macro-economic trend. Accordingly, it asserts the indispensability of public funding of national and supra-national programmes of poverty-reduction and social cohesion. It also asserts the centrality of a positive narrative of social equity, of welfare as a public 'good' rather than as a public cost. It thus suggests the replacement of the imperative of fiscal 'sustainability', rooted in ordo-liberal budgetary constraints, by principles of fiscal 'viability', rooted in harmonised European standards of taxation. The Report notes the erosion of progressivity in European tax systems, most notably in newer Member States, and the increasing dependence of these states on regressive indirect taxation - a process tolerated by the EU's permissive, supply-side policy-preferences. The article concludes that a transformative programme of social investment in Europe is impossible without the restoration of fiscal viability through the outlawing of flat-tax regimes within the EU and the end of destructive tax competition between European States.

1. The rhetoric of social investment

It is relatively easy to articulate a best-case abstract macro-economic/macro-political model of social investment in Europe, promoting the 'capabilities' and life chances of individual citizens in a strong and supportive social context. To achieve the socially enriching inclusion of the daughter of farmers in Ireland, of the son of a street cleaner in Romania, the single teenage parent in Finland and the redundant young dockworker in Portugal, some key elements would arguably need to be in place:

1. a shared vision of social justice and progress among the citizens of the Member States of the European Union that transcends party political, class, religious and other cleavages qua broad consensus;
2. shared/harmonised processes of legitimation, checks and balances at all levels of political and economic governance; democracy and subsidiarity;
3. refined structures of multi-level monetary governance, providing the effective transmission of monetary policy and monetary resources - money stocks, currencies, national and international clearing - to ensure the maintenance of stability and predictability in the circuits of investment, production, consumption and exchange.
4. refined structures of multi-level fiscal governance, which ensure optimal revenue at different levels of public policy (central, regional, local), along with a just distribution of tax burdens; primary disparities of resource distribution (regional, local, structural, international) MUST be subject to sophisticated systems of vertical and horizontal fiscal equalisation, rooted in a macro-economic development strategy committed to Convergence (of productivity, living standards, life chances). Any such system of fiscal equalisation within the EU requires an extensive harmonisation of tax arrangements (rates, ratios, accounting standards, progressivity) across all Member States.
5. a culture of compliance - legal and normative - enforced by a shared trust in the institutions of national and international law and the daily processes of interdependent social existence; 'citizenship training' at both national level (schools, colleges, NGOs) and international level (ERASMUS-Plus), not confined to HE students, would seem desirable.

The translation of this simple abstract model into something like social and political reality is quite another thing, however. Firstly, it goes considerably beyond the social investment-programme envisaged and launched by the EU in its 2013 social investment package. While the rhetoric stresses the core objectives of social inclusion and the elimination of poverty and limited life chances, the concrete results of the social investment-initiative are clearly disappointing.

The social investment narrative is the very particular product of the European Union's shift from a simple, regulated customs union with mercantilist arrangements for the strategic sectors of agriculture and heavy industry, to an enlarged and 'deepened' union rooted in a liberalised single market. The Single Market Act, signed off in Luxembourg in February 1986 and entering into force on 1 January 1993, involves the unhindered exchange of goods, services, capital and labour across the borders of the Member States of the EU and four associate states: Norway, Switzerland, Iceland and Liechtenstein. Where the single market initiative was essentially a reactive response to the dramatic collapse of Keynes' Bretton Woods system in the 1970s and the subsequent abandonment of exchange controls, Jacques Delors' attempt to add a social dimension to the Single Market was arguably a pre-emptive move to cushion the effects of permissive trading regimes and the 'stability' imperative of Germany's and the US' autonomous central banks.

Even before the effects of eastern enlargement on wage-setting and employment rights set in, there was a concern on the part of Europe's social democrats and other progressive political forces that the mobility of both physical and financial capital could create the potential for the erosion of social rights, for the use of 'social dumping' deriving from a new competition between EU states for the favours of inward-investing companies. Elmar Altvater and others described this process as the emergence of a new 'competition state' (Altvater, 1997) which contained the seeds of both rising inequalities and weakened regulation within the supposedly 'deepened' European Union. The simple liberalisation of the factors of economic production (capital, labour, goods and services) ran the clear risk of reducing the power of harmonised European standards of social protection, a risk that was reinforced by the broader effects of global liberalisation and lower transport costs (e.g. through cheaper oil).

In 2013 - five years into the European Union's deepest economic crisis - the European Commission announced its *social investment package for growth and social cohesion* (European Commission, 2013a). It represented a social policy counterpart to the 2015 *European fund for strategic investment*, established in 2015, and dubbed The Juncker plan. While both plans represented initiatives to address the acknowledged slump in Europe's aggregate investment ratio[1] from 22.6% in 2007 to 19.2% in 2013, and the evident pessimism about the economic recovery of the region that is expressed by the reluctance to invest, the social investment package was directed towards the glaring social disparities within and between individual Member States of the EU, most dramatically shown in high levels of youth unemployment, of material deprivation and labour migration among other things.

Ensuring some kind of social policy commitment, to both cushion citizens from endogenous and exogenous shocks, and to enhance their employability was considered an urgent counterbalance to liberalised markets. As Delors observes in 2016: *'if European policy-making jeopardises cohesion and sacrifices social standards, there is no chance for the European project to gather support from European citizens'* (Delors et al., 2016). The launch document of the EU's social investment package indicates a strong 'activation' dimension in its emphasis on enabling individuals to participate in the labour market.

> *'The social investment package sets out a strong case for the contribution that well-designed social policies can make to economic growth as well as to protecting people from poverty and acting as economic stabilisers. It stresses that welfare systems fulfil three functions: social investment, social protection and stabilisation of the economy. Indeed, the social investment approach strongly relies on the assumption that social and economic policies are mutually reinforcing and that the former, when framed in a social investment perspective, does represent a "precondition" for future economic and employment growth. Social investment involves strengthening people's current and future capacities. In other words, as well as having immediate effects, social policies also have lasting impacts by offering economic and social returns over time, notably in terms of employment prospects or labour incomes. In particular, social investment helps to "prepare" people to confront life's risks, rather than simply "repairing" the consequences. Social investment, as outlined in the SIP, is thus the set of policy measures and instruments that consist of investments in human capital and enhancement of people's capacity to participate in social and economic life and in the labour market.'* (Bouget et al., 2015: 4).

It is this final sentence that locates the function of social investment firmly within the *activation* narrative of neoliberalism. Without the reproduction and enhancement of labour power (human capital), the reproduction of commercial capital - qua economic 'returns' - is endangered; this argument remains persuasive only as long as one accepts the implied congruence of human capital and commercial capital in a unitary process of value-creation: investment, employment, production, distribution, consumption and saving. Europe's economic and social development before and beyond 2008 raise clear doubts about this assumed congruence of human capital and commercial capital. The long social crisis in the EU which was triggered by the 2008 crash was clearly not confined to the southern and eastern 'peripheries'; there were surprisingly high levels of people 'at risk of poverty' in Germany (32.7%), Belgium (27.8%) and Sweden (24.3%) in 2014. Nevertheless, there were truly chronic levels of hardship in Bulgaria, Romania, Greece, Spain and Portugal,

1 The investment ratio denotes the proportion of gross investments (gross fixed capital formation) as a percentage of annual GDP.

which represented major challenges to the European Union's commitments to social and economic convergence (c.f. Preamble to the Rome Treaty)[2] and to the specific targets of the Europe 2020 Programme 2010): namely removing 20 million Europeans from poverty by 2020 and raising aggregate employment levels to 75% of the working population - from the then 69%. By 2013 or 2015 or indeed 2016, neither of these core social targets looked remotely achievable. They remain elusive at the time of writing (September, 2018). There is little doubt that the slump of the last ten years damaged the prospects of the EU realising the visions of Delors and of Prodi of an embedded social dimension within the liberalised single market; of equal, if not greater importance was the maintenance and intensification of budgetary consolidation within the EU28 as primary macro-economic objective. The scale of policy failure is evident from the data provided in Table 3.1.

It is important to note, however, that the challenges of social deprivation had been expressly acknowledged by the European Commission; *social policy was now being couched in the language of general economic progress*; social investment - at the very least - invoked the interdependence between national economic prosperity, the socio-economic skills of the population and social cohesion. The formation of 'human capital' is mentioned 27 times in the launch communication (European Commission, 2013a); its role in economic growth is central to the message of the launch document. The quality of human labour power in its social context is implicit in the new vocabulary of 'smart growth' that informs both the Lisbon and the Europe 2020 agendas; innovation, skills, flexibility, adaptability become the bywords of a visionary integrated strategy. The seven 'flagship' initiatives of Europe 2020 present a societal link between inclusive growth and education and training, along with the boosting of R&D expenditure to 3% of GDP, decarbonisation and environmental sustainability, small business promotion and poverty-reduction. At the analytical level, Commission thinking about societal progress in the future would seem at the very least to have a holistic dimension as its point of departure for policy-development. So far, so good. There is indeed little in the prospectus for smart, sustainable growth and social cohesion to which an outside observer could object.

The difficulty, as so often, arises when the rhetoric is examined against the economic and social realities of the European Union in the 21st century, both before and after the Great Crisis of 2008, and against the virtual absence of earmarked EU-resources for such an ambitious project. Here the ideological context is critical, since EU policy preferences are informed by a very limited conception of what the state or the public sector can achieve and by a very broad and optimistic conception of what market forces and private economic agents can achieve. This has a clear bearing on the design of the social investment package. The EU and most of its Member States operate in large measure according to the so-called neo-liberal paradigm of deregulation and liberalisation, launched in the 1980s, which above all denies state authorities a central role in the allocation of social resources. In line with German 'ordo-liberal' principles, the state is expected to confine itself to providing the framework, within which private market agents can invest, employ, produce, generate favourable rates of return and distribute. The framework 'order' is accordingly rooted in 'sound' monetary policy, committed to price stability and to preventing the 'crowding-out' of private credit and investment by strict controls on public borrowing and debt (Leaman, 2012b). Fiscal policy has thereby been subordinated to the strictures of monetarist orthodoxy ever since the ratification of the Maastricht Treaty in 1992 and the conditions of fiscal austerity placed on all candidates for membership of the European Monetary Union. These conditions have remained in place since 1992, and most notably since the outbreak of the Great Financial Crisis of 2008; furthermore, they are considered by many commentators to have been co-responsible for the (pro-cyclical) transformation of the crisis into a profound economic slump (Chowdury, 2012; Lehndorff, 2012; Wren-Lewis, 2015; etc.). The rhetoric of 'order' thus arguably shows a stark contrast to a real 'hegemony of disorder' in practice (Leaman, 2018a).

We are thus faced, at the beginning of this analysis, with a conundrum of a noisily trumpeted public policy announcement by the European Commission - the highly *political* social investment package - and an ideology which seeks to *reduce political intervention* in the operations of market economies. Of course, this is

2 The signatories of the Rome Treaty stated that 'the essential objective of their efforts' to be 'the constant improvement of the living and working conditions of their peoples'.

only a conundrum to critics of EU orthodoxy like the author of this article; the architects of the social investment package (and indeed of the Juncker investment plan) assume that the translation of the package (SIP) into real economic and social life would be achieved by modest but imaginative 'activation' measures by state agencies, using limited fiscal resources alongside a set of supply-side incentives, in order to leverage large-scale commitments of private investment funds into areas of activity identified by political agencies as strategically important.

While state promotion of private investment in the provision of physical public infrastructure has become commonplace within the neo-liberal paradigm - exemplified by 'public-private partnerships' in the construction of schools, hospitals, prisons and other public buildings - the idea of mobilising private capital to finance social policy initiatives breaks new ground. Predictably, therefore, the SIP has been criticised by some observers because it 're-commodifies' social welfare and suffers from limited time-horizons (De La Porte & Jacobsen, 2014). Furthermore, it is rendered unachievable by the countervailing effects of budgetary austerity according to the European Anti-Poverty Network (EAPN, 2013). This author shares such scepticism. Like so many abstract concepts in social and political analysis - freedom, justice, equality, value, development, progress, welfare, cohesion - social investment is susceptible to arbitrary epistemological and political distortion, informed by factors of social interest and power. The RE-InVEST research project is located at the 'transformative' end of the reform spectrum, albeit within a soberly pragmatic mindset that acknowledges the virtue of more limited, ameliorative changes to the welfare and life-skills agenda. The Sen/Nussbaum approach, to which the research project is committed implies both a radical point of departure in social and economic analysis and a reform potential that goes far beyond the discretionary instrumentalisation of social investment for cushioning the neoliberal model of liberalisation, deregulation and privatisation.

The reality of many European welfare states - and not just in the poorer Member States in Central and Eastern Europe - reveals real cutbacks in social expenditure, the weakening of citizens' social security and a worsening of public fiscal potential, as a result of both fundamental structural problems of fiscal governance and of dysfunctional budgetary 'consolidation'. This article argues that, *without a radical recalibration of fiscal policy at both EU-level and within individual Member States, the SIP will fail.* Above all, the universal social services, which are the foundation of social security, can and should be funded out of public revenues within harmonised and fair systems of taxation. In his exposition of the *Courageous State*, Richard Murphy seeks to reassert not simply the principle of collective fiscal responsibility for both physical and social infrastructure but its culturally enriching function: 'because all the services have universal benefit, much of which extends way beyond the reaches of the market price mechanism, ... the market cannot also procure these services. Only the state can. And the fact that it does should be a cause for celebration for us all' (Murphy, 2011: 55-6). Murphy invokes the need for a new narrative of the state, of civic pride in the collective provision and financing of public goods, echoing the famous words of Oliver Wendell Holmes that 'taxes are what we pay for civilized society'. This article accordingly pays critical attention to issues of fair taxation and fiscal viability as absolute pre-conditions for civilized social policy, effective investment in which can only be the function of the state.

2. The role of the state and the private sector in funding social investment

The fact that the European Commission has put social investment on the political agenda is nevertheless important. However, of itself, it clearly insufficient to justify the actual shape of the programme as outlined in the SIP. What seems clear from the launch document is that the logic of the SIP goes beyond the metaphor of committing resources to ensure long-term social stability - i.e. the core function of the social state in post-war western Europe, funded through taxation and/or social levies - to a more clearly defined *commercial logic* of a commitment of capital, in the expectation of an attractive financial return. The launch document thus contains repeated references to the mobilisation of private capital to fund 'social investments' in order to achieve 'budgetary savings' (EU Commission 2013: 6). There is a specific focus on the role of 'social impact bonds', which incentivise private investors to finance social programmes by offering returns from the public sector if the programmes achieve positive social outcomes' (ibid.: 19). Such private participation in the EU's social investment-programme is accordingly seen as indispensable: 'Innovative financing of social investment from private and third sector resources is *crucial* (my emphasis JL) to complement public sector efforts' (ibid.: 17). The constraints on public budgets are cited repeatedly (ibid.: 2, 6, 8, 13, 18). EU-funding will be a valuable 'catalyst' (p.16) but little more: 'The Commission will continue to provide support from the structural funds, notably the ESF, but new financing tools can be used and should be exploited with a view to *easing budgetary consolidation by greater involvement of private funding* (my emphasis JL)' (p. 18). There is strong encouragement from the Commission for Member States to make better use of Cohesion Fund resources for the purposes of social investment, but the fundamental change offered by the SIP is to 'explore and develop innovative ways of securing additional private financing for social investment' (p. 12). This represents a qualitative shift in social policy discourse which needs, briefly, to be unpacked.

2.1 Social investment and the economics of rent

In the new debate surrounding social investment (Hemerijk, 2015, 2017; Morel et al., 2016; De la Porte et al., 2014; EAPN, 2013; Deeming & Smyth, 2015), there is a strong tendency to suggest that it constitutes a paradigm-shift away from neoliberalism (particularly Hemerijk, 2015; Morel et al., 2016). While the 'necessity to more clearly distinguish its ideas from the previous neoliberal paradigm' is conceded (Morel et al., :27), the distinction is nevertheless enthusiastically invoked and serious attempts to identify social investment in terms of a new typology of social welfare are being made, even if a definitive judgement is not yet possible (Hemerijk, 2016).

Buxbaum and Wöss (2015) see no such paradigm-shift. This article agrees, but also suggests that the Commission's social investment-initiative in fact reflects *adaptive behaviour within the neoliberal paradigm* and not something that threatens to supplant neoliberalism. Above all, it would seem to be a form of defensive adaptation in the context of widespread concerns about the destructive potential of financialised capitalism in the wake of the 2008 crisis. Indeed, the rhetoric of smart, inclusive growth conceals pervasive continuities in the structures and processes of ownership, investment, production and accumulation; private decision-making remains primal in the deployment of investment capital; increasing privatisation of both the capital assets necessary for social provision and the day-to-day delivery of 'public goods' characterises the trend in a majority of the EU's Member States. Moreover, the operation of private agencies within the sector of universally applicable social policies has the increasing quality of *rent-seeking*, with public guarantees of the flow of what are little more than monopoly rents, qua income streams. The ‘risk-reward’ nexus (Mazzucato: 200f) remains tilted in favour of private capital; moreover, the chronic asymmetries of investment and innovation, which favour the parasitic milking of monopolised assets and weaken productive, innovative investment are arguably further reinforced by the invitation to private ‘social investors’ to seek safe returns within state regulated social policy fields (EC 2013: 19).

This is why the distinction between the metaphor of social investment as prudent planning by public authorities, on the one hand, and the financialised risk-reward relationships of marketable bonds or transferrable equity is vitally important. Setting aside the need for social investment bonds to be made sufficiently attractive within an, often volatile, market for securities, there is a clear danger that the core policy objective of comprehensive and universal improvement and maintenance of social welfare will still require public authorities to incur the greatest risk. This would mean a repeat of the traditional (and unacceptable) privatisation of reward and socialisation of risk, that has been so evident during the extended crisis after 2008. (See Box on Social Impact Bonds).

A further argument in support of publicly funded social investment is the role it should play in promoting the narrative of social inclusion and solidarity. Civic pride in the collective, shared provision of social security, education and health are, arguably vital for the long-term success of any ‘social state’. A positive narrative of fair and adequate taxation and social levies is indispensable, particularly in the context in which resentment towards the state and towards taxation has been deliberately cultivated as part of the neoliberal paradigm. The positive narrative of social solidarity is not served by the construction of a system of cosy rents enjoyed by a minority of private investment funds. Where, on the one hand, arguments in favour of private social bonds are informed by the priority goals of budgetary austerity, any failure to mobilise a sufficiently large critical mass of private capital in a cyclical upswing would have critical consequences in a cyclical downturn, when the austerity imperative would again be more strongly invoked by states threatened by the EU’s excessive deficit proceedings.[3]

The public funding of social investment is thus desirable and unavoidable, if its ambitions are to be realised in the medium term. This produces the obvious conclusion that the resources devoted to social investment should be adequate and appropriate to the imperative of convergent economic and social development across all Member States of the European Union. From this perspective, the macro-economic preconditions in the current period of time, in 2018, are far from ideal. In the general context of very weak recovery of the whole Union since 2008, the twenty-eight Member States display wide disparities of social security, levels of poverty and deprivation, levels of public expenditure on social policy and overall fiscal strength, as the charts over the following pages demonstrate. These disparities represent one of the central challenges of a European Union committed to convergence and cohesion.

2.2 Experience with social impact bonds

Setting aside issues relating to collective responsibility for the funding and management of social investment for the moment, it is appropriate to examine the evidence for the effectiveness of bond-financed social projects for both private investors and the public or para-public commissioning bodies from a macro-economic perspective. It is too early perhaps to assess the longer-term feasibility of privately funded social investment, given the relative newness of such innovations and the absence of a critical mass of both projects and independent monitoring of their progress over time. Their emergence, as either an offshoot of ‘ethical investment’ or as a specific vehicle of New Public Management, has been only recent, limited in scale, varied in nature, duration and motivation. We can, however, offer an interim judgement about their effectiveness.

The idea of bond-financed social investment became more appealing to policy-makers after the Great Crisis, which ‘created fertile soil for new, innovative funding mechanisms and delivery agreements for social

3 It is noteworthy that the Commission persisted in initiating ‘excessive deficit procedures’ against 26 out of 27 EU Member States in 2009, in the fiercest economic recession since 1945.

services' (McHugh et al., 2013: 253). The first experiments with such investment vehicles were Social Impact Bonds. Clara Miller (2015) summarises the enthusiasm of proponents of these financial innovations in the expectation that 'SIBs will revolutionise the way government provides social services, unleashing private capital for public good'. *Big Society Capital*, the UK's recently launched social investment vehicle, reflected optimism in SIBs in its 2014 review of progress: '*SIBs offer an exciting opportunity to rethink public sector service delivery and test innovative models of service provision by the social sector'* (Kuznetsova & Palumbo 2014: 16).

It should be said that these interim positive assessments of SIBs are, overall, lukewarm at best; others are highly critical. The following is a brief summary of the main reasons for scepticism that privately financed social investment actually delivers the results expected of them.

- A common theme of the critique of SIBs is the difficulty in creating a broad base of investors to support large-scale social investment projects; the pool of investors hitherto has been dominated by traditional philanthropic finance sources (c.f. Gustafsson-Wright et al., 2015; 16; Kuznetsova & Palumbo, 2014: 3). This is attributable, arguably, to the debate about rates of return (RoR) on SIBs. With reference to a 'highly publicised Rikers Island recidivism project', Rick Cohen reported a contracted rate of return for Goldman Sachs of 22% on a $9.6 million investment (Cohen, 2014), but he also points out that $7.2 million of this investment was guaranteed by Bloomberg Philanthropies. 'The result, in terms of actual risk, is that Goldman Sachs is risking $2.4 million to potentially ear $2.1 million, an 87.5% return'.[4] Such cases raise questions about the political design of SIBs, as investment vehicles with public backing.
- The question of RoRs in contracted SIBs thus also raises the issue of the distribution of risk, namely whether commissioning public or third sector bodies might be obliged, firstly, to shoulder a higher level of risk in order to attract finance capital and whether, secondly, the time-horizons of such projects (maturation period of the bonds) would be of shorter duration than generally necessary for longer-term social investments. Miller identifies a clear trend of SIBs tending 'to focus financial resources on remedies where measurement of financial savings is the most reliable and short term', with the result that 'we trade this low-hanging fruit for much more desirable but tough to measure long-term social investments' (Miller, 2016). In this context, Miller, McHugh et al., (2013: 3) and Roy et al., (2018) stress the political incentive to limit both the level of complexity and the transaction costs of SIBs - factors which increase both with the scale and the duration of projects. Preference for the 'low-hanging fruit' clearly creates the danger of neglecting core areas of social concern – 'universal prenatal care, great pre-school and school, college and trade-school scholarships, not to mention living-wage jobs for parents' - because they are both 'longer-term in nature and have less circumscribed social return' (Miller, 2016).
- The introduction of a new relationship between commissioning body (local authority, charity, government department) and private provider in a privately financed social investment project does not simply add new layers of administration to a hitherto bi-lateral arrangement, but requires - in the short term, at least - additional monitoring and measuring skills on the part of commissioning parties, skills which they frequently do not have, and the development and maintenance of which increase the recurrent costs of managing SIB-led projects (McHugh et al., 2018) even if they create a new 'culture of monitoring and evaluation' Gustafsson-Wright et al., 2015: 36, etc.). The question is therefore whether these, transaction costs could not have been avoided and the resources deployed more directly and more effectively, particularly in the context of budgetary austerity.
- The Brookings report on SIBs includes a valuable survey of the differing motivations behind decisions to participate (or not) in projects (Gustafsson-Wright et al., 2015: 25f), distinguishing outcome funders, intermediaries, service-providers and senior investors as key stakeholders. The clear contrasts in perspective and weighting are predictable and, regardless of the particular preferences, indicate the fundamental difficulties for the architects of projects/bond-offerings in managing the new and more complex dynamics

4 Cohen also raises the issue of state inducements to companies investing in social projects, not simply in terms of limiting commercial risks, but also allowing investments to be taxed more benignly as charitable contributions, or allowing losses on Payment by Return projects to be offset against tax liabilities (c.f. Cohen, 2014).

of reconciling conflicting priorities. Fraser et al., also underscore particular 'elements that appear to reduce the odds of improving outcomes', including 'misunderstandings between partner organisations about risk allocation, access to finance and the implications of underperformance', in turn 'heightening the risk of inter-organisational turbulence' (Fraser et al., 2018). With additional motivational drivers from at least four distinct groups of stakeholders, there is also a danger that lines of responsibility are stretched and that the important checks and balances of answerability are diluted. That is, the potential for passing the buck is far greater than in arrangements with fewer layers of interest.
- Several commentators emphasise the fundamental difficulty of, firstly, measuring value-added by particular agencies in the multidimensional field of social policy and, secondly, of apportioning credit and a monetised reward (McHugh et al., 2018; Gustafsson-Wright et al., 2015: 141f; Murphy 2018; 49). With the possible exception of very specific and narrowly targeted interventions like the reduction of recidivism in individual prisons, a clear causality in generating outcomes would, according to this view, seem to be elusive and dangerously contentious.
- Finally, several commentators suggest that there is, as yet, no evidence that SIBs actually promote the predicted innovations that had formed such a key argument of their proponents; indeed, there is stronger evidence that 'financiers motivated by a return on investment (as opposed to meeting social objectives) have little incentive to fund risky innovative policy experiments' (McHugh et al., 2018). Indeed, the official report into the UK's SIB supporting a programme to reduce re-offending among released prisoners (Peterborough project) asserted that 'there is no compelling reasons to believe that SIB funding on its own fosters innovation' (Disley et al., 2015: 59; c.f. also Gustafsson-Wright et al., 2015; Birtwistle 2016). Accordingly, the trade-off between increased complexity and effectiveness *qua* innovation is absent, rendering the additional cost unnecessary.

Commentaries about the effectiveness of SIBs would thus at best confirm their marginal value for simple, limited and narrowly defined projects. They therefore do not constitute a viable alternative for large-scale social investments. Several commentators suggest that the uncritical 'hype' accompanying the ambition to roll out further SIBs is 'ideological, rather than evidential' (McHugh et al., 2018). '(O)f greater concern is the unintentional (or otherwise) effect of introducing the SIB model into the realm of service delivery previously infused with a public-sector ethos. This represents a boundary shift that *profoundly alters the character of the service*' (ibid. my emphasis JL). 'SIBs are therefore the latest stage in an ideological shift which favours removing delivery of social and welfare services from conventional public or third sector providers, and they mark a significant challenge to the traditional ethos and operation of the voluntary and community sector' (McHugh et al., 2013: 253).

One of the strongest themes addressed by critics of private funding of social investment is the 'recommodification' (de la Porte & Jacobsen, 2012), 'monetisation' (Gustafsson et al., 2015) or 'financialisation of social policy' (McHugh et al., 2013; Roy et al., 2018; Tse & Warner, 2018). The post-war decommodification of welfare (indeed even the old parish-based Poor Laws) was underpinned by a fundamental principle of collective responsibility for the well-being of citizens; this principle is, arguably, eroded by a situation where 'the changing fortunes of citizens (are) instrumentalised as payment triggers' (McHugh et al., 2018). This level of criticism indicates a fundamental ideological/philosophical contrast between a view of social investment that is rooted in neoliberal deregulationism and privatisation, and another that remains committed to a holistic and collective management of social policy, funded overwhelmingly by taxation and state social levies. This latter view, to which this author subscribes, is not simply informed by the empirical observation that privately funded social investment is *demonstrably incapable of being scaled up to cope with the development of coordinated, long-term macro-level policy making*. Private investment is, essentially, discretionary in nature, based on the strategic discrimination (choice) between measurable commercial reward or rate of return. The 'social return' will remain a second-order consideration for the vast majority of financiers, and one which is far more difficult to measure and therefore to attribute to one or more agents in the 'value-chain'. The traditional ambition of advanced welfare states to ensure the well-being of all members of the population and maintain their democratic trust is potentially undermined by the reduction of social policy targets to an asset class alongside other objectified/commodified securities (equities, mortgage bonds, CDOs, commodity and financial futures, market tracker bonds, etc.).

Social cohesion and the policies designed to achieve its effective delivery (supranationally in the case of the EU) cannot be reduced to 'mechanical levers' deployed with any measurable certainty. Rather, they are 'organic processes' (McHugh et al., 2013), the *variability of which defies monetisation and rent-extraction*. Above all, the political and economic sustainability of social cohesion and its constituent investment processes requires a deep-seated layer of democratic legitimation in the form of a commonly accepted narrative of shared social (and ecological) responsibility which binds all citizens to a vision of distributional justice and humanity for current and future generations.

The most telling objection to the introduction of bond-financed social investment is the fact that it *promotes further financialisation* and rent-seeking, and thereby reinforces one of the central threats to a form of capitalism, rooted in productive investment. A critical feature of the neoliberal 'revolution' was the permissive nature of its deregulation and privatisation programmes; both were rooted rhetorically in the 'efficient market' hypothesis and the supremacy of the market 'efficiencies' generated by private commercial strategies. This rhetoric of a market-driven efficient 'order' arguably ushered in a reality of a global 'disorder' which distorted market forces, tolerated unprecedented processes of consolidation and monopolisation and stripped nation states of the ability to control macro-economic processes in a balanced and sustainable way (Leaman, 2018a). Above all the weakening of real investments in the advanced economies of the 'West' and the diversion of vast reserves of capital into the financial assets generated a set of Ponzi-style bubbles which burst in 2007-8 and drove most major states into the worst slump in living memory.

The supposedly new 'paradigm' of social investment (Hemerijk, 2012: 33) looks more and more like a means of perpetuating the old paradigm of permissive neoliberalism: generating a new income stream for the valorisation of capital on top of the privatised natural monopolies, public-private-partnerships, all with rates of return effectively guaranteed by the state. It is no coincidence that the expansion of financial services and their vast range of investment 'products' has been accompanied by a marked decline in the real investment ratio in most OECD countries.[5] Critical economists assert that this represents a fundamental misallocation of capital (Huffschmid, 2002; Strange, 1998; Mellor, 2010; Black, 2011); others speak persuasively of the 'predatory' nature of financialised capitalism (Black, 2011; Mazzucato, 2018) which starves productive investment of financial resources.

While investing in social policy programmes undeniably has the potential to enhance and maintain the welfare of citizens - in contrast to many of the processes of financial 'investment' -[6] and adds value directly or indirectly to the macro-economy, the addition of new layers of financing, regulating and managing social policy programmes facilitates 'value-extraction' as described in Mazzucato's analysis (2018: 4ff). These new layers, particularly if they fail to generate innovations, represent a superfluous diversion of precious resources and precious time.

2.3 Taxation, the tax base and philosophical concepts of justice

Historically taxation discourse has always been highly controversial. Popular resentment against taxation has often had the upper hand, fed in particular by the very real abuse of sovereign power on the part of autocratic elites to extract 'tributes' from subaltern classes to fund dynastic wars, aristocratic whim and lavish lifestyles. Taxes on essential items of human consumption (salt, sugar, water, bread) or other items like beer, spirits, hats, beehives, beards or windows did not remotely reflect any desire to enhance the welfare of citizens, but rather to maintain strict hierarchical order and suppress unrest and rebellion. Indeed, rebellions were frequently sparked off by hostility to punitive taxes, most notably in the American War of Independence with

5 Gross fixed capital formation in the countries of the European Union averaged 26.5% of GDP in 1970, 24.8% in 1980, 23.9% in 1990, 22.1% in 2000 and 20.0% in 2017 (figures World Bank data); the CPM chart shows the growth of global financial assets from a mere $10 trillion in 1980 to over $260 trillion in 2014, a trend which is only slightly dented by the great financial crisis of 2008-2009.

6 These processes have been dubbed socially 'useless' by Adair Turner (ref) and many others.

its slogan ‘No taxation without representation’. Benjamin Franklin’s dictum of 1789 that *‘in this world nothing can be said to be certain, except death and taxes’* is accordingly cited more often than the original source, Daniel Defoe’s *The Political History of the Devil* of 1726.

This malign view of taxation has continued to inform popular taxation discourse even after the fundamental shift to democratic state forms in the nineteenth and twentieth centuries, i.e. even when representation allowed a degree of democratic influence on taxation policy. Thus, while a new benign narrative of taxation - the ‘price we pay for civilisation’ - is given scientific support by Wagner’s Law, with its logic of politico-economic complexity - the older, simpler narrative of taxation as unjust confiscation is retained within the competitive party systems of the new ‘liberal democracies’. Good expropriation to fund welfare-enhancing public goods thus competes with the suspicion of welfare-damaging, bad expropriation. This polarity is sustained by evidence of the continued real misuse of taxation and other fiscal resources by regimes both democratic and autocratic. Bad government, poor policies, corruption persist. Rival paradigms of economic governance - most recently visible in the struggle between variants of interventionist Keynesianism and of anti-interventionist Ordo-Liberalism - operate within the bounds of a pendulum-swing between justifiable and unjustifiable expropriation. This is also evident in the discourse of ‘optimal tax’ theories (refs).

This conceptual frame - the pendulum - has been called into question by two leading political philosophers, Liam Murphy and Thomas Nagel in their book, *The Myth of Ownership: Taxes and Justice* (2002); the core hypothesis of the book is that the domestic assets and the annual domestic product of a jurisdiction are essentially social in nature but distributed according to legal conventions favouring social elites and hierarchies of power. Property, in this account, has no ethical or universal dimension:

> *‘The conventional nature of property is both perfectly obvious and remarkably easy to forget. We are all born into an elaborately structured legal system governing the acquisition, exchange, and transmission of property rights, and ownership comes to seem the most natural thing in the world. But the modern economy, in which we earn our salaries, own our homes, bank accounts, retirement savings, and personal possessions, and in which we can use our resources to consume or invest, would be impossible without the framework provided by government supported by taxes. This doesn’t mean that taxes are beyond evaluation - only that the target of evaluation must be the system of property rights that they make possible (my emphasis JL). We cannot start by taking as given, and neither in need of justification nor subject to critical evaluation some initial allocation of possessions - what people originally own, what is theirs, prior to government interference.’* (Murphy & Nagel 2002: 8).

This is critically relevant for the traditional narratives of taxation, because the questioning of the conventional assumptions concerning property raises, in turn, questions about the historical process of creating and accumulating ‘value’, as the thing to be taxed; this is thus represented by both total capital stock within a jurisdiction/state and by the goods and services traded annually *qua* GDP. As Mazzucato (2018: 222) points out, dividing up the fruits of wealth creation according to individual ‘deserts’ and notions of entitlement, was easier in the past in ‘a production system where individual labour was more important, and was easier to identify, than it is today when collective contributions have been central to technology-driven growth’. Even if earlier notions of entitlement ignored both the vital role of the state and the crass exploitation of the labour of slaves, wage labourers and economically weaker citizens, the mechanics of investment, innovation, risk and reward still seemed to match an obvious logic which involved individual inputs, deserving of reward. In the 21st century, the extraordinary complexity of interconnected global arrangements for production and trade makes the ascription of merit and quantifiable reward to individuals hazardous at the very least and, against the background of increasing disparities of income and wealth worldwide, arguably impossible to justify on grounds of social cohesion or social justice.

> *‘Ignoring this collectively produced social system, certain individuals feel justified in earning a much higher proportion of a nation’s income than their own contribution warrants. But, more specifically, it has affected policies on taxes, patents and prices, thus fuelling the dynamics of inequality.’* (Mazzucato, 2018: 222).

The philosophical observations of Murphy, Nagel, Mazzucato and others about the nature of property and value, demand a much more refined analysis of human economic and social endeavour in the new century than is currently afforded by the conventional narratives of macro-economic affairs, in particular the Ordo-liberal narrative which clings to an a-historical notion of the limited role of the state and the primacy of private entrepreneurship in investment, production and service-provision. Where the Ordo-liberal and Neo-liberal narrative postulates a separation of macro-economic functions between the legal *order* (state framework for ensuring competition and for the provision of money) and the everyday *process* of market-driven investment and value-creation, the heterodox view insists on the indivisibility of the 'collectively produced social system' and the measurement of macro-economic success in terms of humane and fair socio-economic outcomes, rather than assuming the purity and sanctity of private decision-making and its associated returns. Mazzucato's demonstration of the crucial role of the 'entrepreneurial state' in the development of Apple products gives the lie to the risk/reward myth of the heroic, frontier pioneer who single-handedly converts genius into world-changing innovations: 'the product's key technologies were based on public investments made in the computer industry during the 1960s and 1970s' (Mazzucato, 2013: 101)

Mazzucato's line of argument is persuasive both in terms of the accumulated sum of human scientific and practical knowledge - 'we stand on the shoulders of giants' - and in terms of the complex interdependence of the modern global political economy. If value-creation, innovation and GDP are genuinely the outcomes of collective action by interdependent social agents, it behoves us to nurture the innovative process in a way which prioritises both social cohesion and just intergenerational legacies. The welfare of contemporary generations of national, regional and global citizens (*qua* distribution of income, wealth, water, mineral resources, education and health) thus sits at the centre of politico-economic endeavour, side-by-side with the commitment to an environmentally and socially just legacy for future generations.

The relevance of the above discourse on value and property to issues of taxation - and state expenditure - is both to stress the complex interdependence of social and economic existence and to question fundamentally the theoretical and empirical basis of the popular narrative of taxation as confiscatory. The multi-factorial nature of value-creation undermines the case for any individual to extract a disproportionately large benefit from an inextricably collective process and to accumulate disproportionately large holdings of property. Accordingly, it requires a much stronger acknowledgement of the role of collective agencies, most notably the 'public sector', in the value-chain and the necessity of the strategic, political management of the 'social product' through the deployment of (increasingly large) proportions of national income to sustain research and investment and the physical and social infrastructure that underpins economic and social cohesion. The degree of political management will vary according to democratic preferences - e.g. for a right-Keynesian paradigm, left-Keynesian welfare capitalism, Scandinavian social democracy, eco-socialism or centralist state socialism - the public sector is obliged to manage economic and social processes politically. Neo-liberal or supply-side paradigms look, accordingly, like aberrations from a trend dictated not by ideology but by complexity. Wagner's Law conversely looks increasingly convincing.

While it is implausible that the Murphy/Nagel/Mazzucato analysis of property and social product might be adopted by any OECD state, it is not unreasonable to suggest that their demolition of the illusory 'certainties' of neo-liberal 'roll-back' logic could and should inform a more progressive narrative of taxation and macro-economic policy-making. Such a conclusion is supported by the evidence of the cost of neo-liberal neglect, in its permissive tolerance of casino capitalism and growing inequalities, of declining real investment, of increasing concentration of capital and the rent-seeking this allows.

3. Viability of the welfare state versus 'race to the bottom' within the EU

3.1 Macro-economic imbalances and divergence within the EU

If one compares the figures provided by Eurostat concerning both the levels of social insecurity in EU Member States and the corresponding levels of expenditure on social protection, the magnitude of the challenge of convergence in social policy is immediately apparent. Table 3.1 below shows the particular disparities between groups of EU states, clustered according to approximate categories of social state. The most striking cases are states in the eastern and southern peripheries (Baltic group, Balkan group, Southern periphery).

While the Nordic, Anglo-Saxon and Continental clusters manifest both lower levels of poverty - measured by the proportion of citizens suffering from severe material deprivation - and *higher relative and absolute levels* of social expenditure, the crisis-hit newer Member States of the southern periphery (Greece, Portugal, Spain) and Italy show much higher levels of material deprivation and lower absolute levels of per capita social expenditure. The relative proportions of social expenditure (as a percentage of GDP or of total state expenditure) in these states arguably reflect the cultures of established west European welfare-capitalist systems; they are habitually grouped in with the EU15, a grouping established before the major enlargements of 2004 and beyond. In contrast the post-communist clusters of the Baltic and Balkan groups manifest both (far) lower absolute and relative levels of social expenditure as well as high levels of material deprivation.

The average GDP-ratio of the Baltic and Balkan states (12.2%) and the ratio of social expenditure to total expenditure (32.6% and 35.3%) are significantly below those of the southern periphery (18.5% and 40.5%). These measurements indicate several significant differences between the two peripheral groups of newer post-communist Member States in central and Eastern Europe and their western European counterparts.

Apart from the very distinctive transition trajectories of the political economies of all five countries, three contrasting features are evident: a) the economic weight of the states, measured by their ownership of assets and their levels of taxation, is far lower than their western counterparts; this reflects the even more radical processes of privatisation in the wake of the collapse of state planning in CEE countries than occurred in the West; the neo-liberal recipes of deregulation and privatisation, in conjunction with the shock of exposure to global competition generated a more radical reduction in public controls of economic assets and activities, as well as a marked dependence on imported capital and inward investment; b) the contradictions of both flawed economic planning and corruption under oppressive Stalinist administrations had reduced trust in the political management of economic affairs; c) the onset of the Great Crisis in 2008, so soon after accession to the EU in 2004/2007, shifted policy priorities in the worst affected states - Balkan and Baltic - to the basic need to protect currencies from high current account deficits (trade and payments) and to comply with the EU's tight fiscal rules governing budget deficits. The social welfare of the citizens of Baltic and Balkan states evidently became a lower priority; this contrasted with the situation of other, older Member States who were unable - or indeed unwilling - to avoid the legal obligations of social protection, triggered by recessions, bankruptcies and rising unemployment. While these so-called 'automatic stabilisers' were still unable to prevent very significant reductions in the living standards and life chances of many recipients of welfare support in western EU states - notably in Greece, Italy, Portugal and Spain - they managed to maintain the cultural norms of welfare institutions and the corresponding expectations of their citizens, as evidenced by higher levels of fiscal commitment to social security.

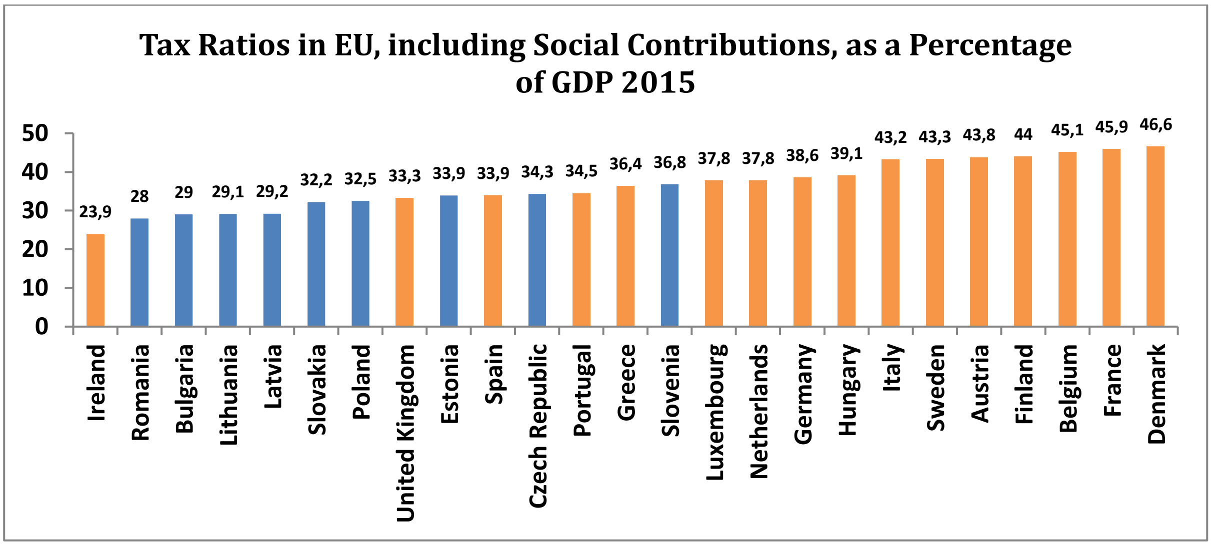
Table 3.1 Divergent welfare conditions in clustered member states of the EU

	Ratio of social expenditure to GDP 2016	Ratio of social expenditure to total expenditure 2016	Social expenditure per capita '000 Euros 2015	Materially deprived (proportion of total population in %) 2016
Nordic				
Denmark	23.4	43.6	15.4	3.7
Finland	25.6	45.8	12.7	2.2
Sweden	20.6	41.7	13.4	0.7
Average	*23.2*	*43.7*	*13.8*	
Anglo-Saxon				
Ireland	9.9	36.4	9.2	7.5
UK	15.8	38.1	11.4	6.1
Average	*12.9*	*37.3*	*10.3*	
Continental				
Austria	21.6	42.6	11.9	3.6
Belgium	20.1	37.6	11.0	5.8
France	24.4	43.3	11.2	4.5
Germany	19.3	43.6	10.8	4.4
Italy	21.1	42.7	8.1	11.5
Luxembourg	18.2	43.1	20.1	2.0
Netherlands	16.2	37.3	12.2	2.6
Average	*20.1*	*41.5*	*12.2*	
Southern Per				
Greece	20.7	41.5	4.3	22.2
Portugal	18.0	40.0	4.5	9.6
Spain	16.8	39.9	5.7	6.4
Average	*18.5*	*40.5*	*4.8*	
Baltic				
Estonia	13.5	33.3	2.5	4.5
Latvia	12.0	32.2	1.7	16.4
Lithuania	11.2	32.2	1.9	13.2
Average	*12.2*	*32.6*	*2.0*	
Balkans				
Bulgaria	12.7	36.4	1.1	34.2
Romania	11.6	34.2	1.2	22.7
Average	*12.2*	*35.3*	*1.2*	
Mixed Group				
Hungary	14.3	30.7	2.1	19.4
Poland	16.9	41.2	2.1	8.1
Croatia	14.7	31.2	2.2	13.7
Average	*15.3*	*34.4*	*2.1*	
Core CEEC				
Czech Rep	12.3	31.2	3.0	5.6
Slovakia	15.1	36.4	2.6	9.0
Slovenia	16.7	37.0	4.5	5.8
Average	*14.7*	*34.9*	*3.4*	
Cyprus	13.8	35.7	4.5	15.4
Malta	12	31.6	3.6	8.1
	12.6	*33.6*	*4.1*	

The comparison of CEE peripheries and the EU's southern periphery aims not to trivialise the colossal damage inflicted on Europe by austerity politics, but simply to explain the even greater vulnerability of the

Baltic and Balkan states to the effects of both systemic transition and of Europe's economic slump: the absence of established systems of social security increased, above all, the pressure on (younger) citizens in the worst affected states to seek work and social protection in other, more affluent EU-states (Riso et al., 2014; 73f, etc.).

Figure 3.1 Tax ratios as indicators of tax viability

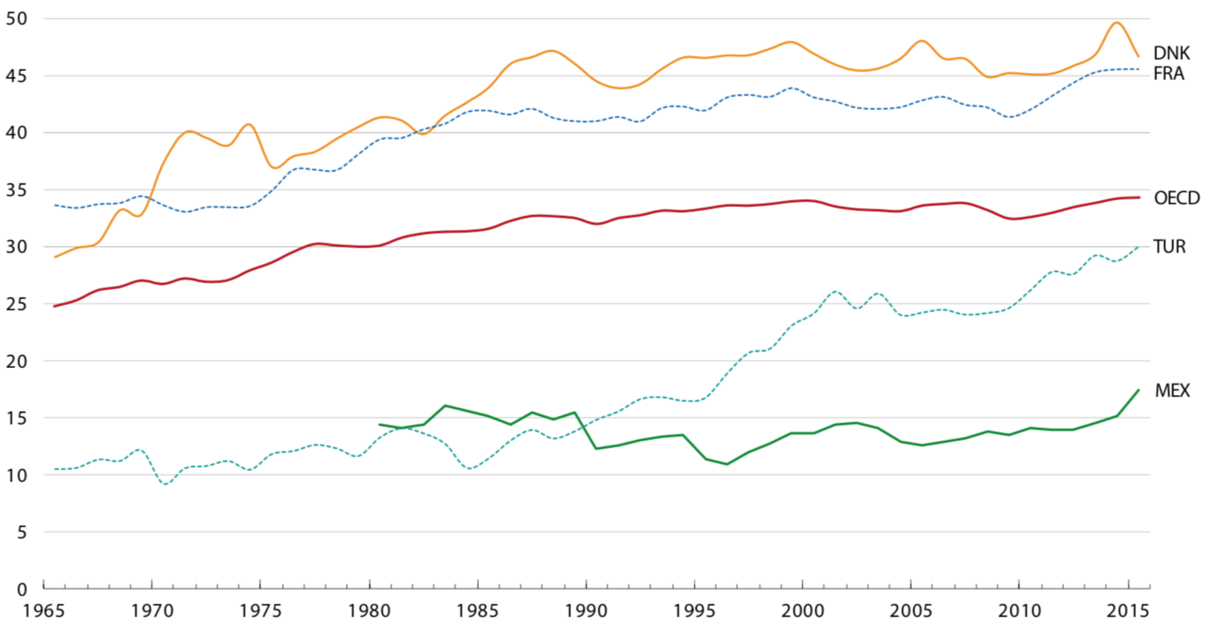


Source Eurostat (2018); EU15 (in orange); CEECs (in blue)

The critical divergences in welfare arrangements across the EU, as indicated by the figures in Table 3.1, suggest both an inability to fund social protection and a reluctance to prioritise that protection in the context of other urgent macro-economic imperatives. Even accounting for factors of purchasing power parity, annual social expenditure per head of population in Bulgaria, Romania, Latvia and Lithuania is dwarfed by the Nordic group's average of €13,800 or the Continental group's average of €12,200 (third column of Table 3.1). The inability to fund is, in turn, critically affected by the markedly lower tax revenues of these weaker states as a proportion of GDP, as indicated by Figure 3.1:

The ratio of taxation to gross domestic product is a fundamental indicator of the fiscal viability of a state, even if other factors must also be considered (Schratzenstaller, 2015); [these factors would include the rates of taxation on income and consumption, the levels of progressivity and tax allowances in particular tax categories, the levels of tax exemptions employed by fiscal authorities, the levels of tax compliance within particular tax cultures and the levels of tax avoidance and tax evasion on the part of tax payers]. Nevertheless, the centrality of adequate fiscal resources to the proper functioning of the modern capitalist state should be an obvious dictum of fiscal governance. There are *both theoretical and empirical grounds for asserting the primacy of the tax ratio in fiscal affairs* and its growing significance historically. The German political economist, Adolph Wagner (1835-1917), asserted persuasively in the 1890s that, with the emergence of an increasingly refined division of labour, along with the increasing demands of an educated, democratic workforce, the state would be required to provide growing levels of physical and social infrastructure and therefore impose higher levels of taxation and expenditure (Wagner 1890). 'Wagner's Law' was subsequently tested by Peacock and Wiseman (1961) and found to be still valid. Recent empirical indicators from the OECD would also seem to confirm the hypothesis, with a clear rising trend of the tax ratio from 1975 to 2016, despite political efforts within this period to 'roll back' the state and allow markets to allocate a greater proportion of social resources. Figure 3.2 shows the long-term trend fairly decisively.

Figure 3.2 Trends in tax to GDP ratios in OECD countries 1965-2016 (as % of GDP)



Source OECD, 2017

The trend curves for Denmark and France would also seem to confirm the correlation of a high tax ratio with higher levels of economic development in Europe. The European Union is clearly also aware of the trend, but not as the demonstration of any law; but rather as a regrettable fact(!) that it has noted in the preamble to every issue of its annual publication on *Taxation Trends in the European Union* (c.f. EC, 2010: 17; EC, 2017b: 16).[7] High taxation, this infers, is a competitive disadvantage for the region; this inference would seem to be the only explanation for the failure of the European Union to establish harmonised principles of taxation beyond the fixing of a minimum standard rate of VAT (at 15%). The non-decisions on other key issues of national taxation systems, above all the failure to prevent the introduction of 'flat tax regimes' in the Baltic states and then in a majority of CEE countries, imply at best indifference to the evolution of tax cultures in the newer Member States and at worst a deliberate encouragement of tax competition between the jurisdictions of the European Union, such that tax 'burdens' are reduced throughout the region. A statement on the EU's taxation website is indicative of a clear neo-liberal/ordo-liberal take on fiscal priorities:

> *'The EU … has no say in how countries* **spend (emphasis in original)** *their tax revenues. However, due to the increasing interdependence of EU economies, countries that overspend and go into too much debt could jeopardise growth in their neighbours and undermine the stability of the eurozone.*
> *To minimise this risk, EU countries try to coordinate their economic policies closely, partly based on recommendations from the Commission. Some of these recommendations refer to national tax policies, seeking to make them fairer, more efficient and more growth-friendly.'*
> Source: https://europa.eu/european-union/topics/taxation_en (accessed 1.5.2018)

In the 2010 *Taxation Trends* publication, i.e. at the height of the Eurozone Crisis and the non-recovery of all economies from the slump, the Commission stresses that the large differences in tax ratios 'depend mainly on social policy choices like public or private provision of services such as old age pensions, health insurance and education, on the extent of public employment, or of State activities, etc.' (EC 2010: 18). The tenor of

7 The wording of the 'high tax' mantra is fairly consistent; unfavourable comparisons are made with other advanced states within the OECD, notably the US and Japan; the role of the Stability and Growth Pact of 1997 is seen as encouraging budgetary consolidation (EC, 2010: 17); the language of the tax 'burden' predominates (EC, 2017: 6, 8, 20, etc.).

Commission discourse on fiscal affairs has thus remained consistently one-eyed, seeking to constrain spending and debt and to render national tax regimes 'more growth-friendly', as well as reducing expenditure preferences to 'choice', ignoring the colossal disparities in levels of economic development within the EU28 and the severe structural challenges of individual Member States, particularly in the context of the worst and longest economic crisis in living memory. More culpably, the Commission ignores the political constraints imposed on Member States by its own arbitrary fiscal rules, established in the Maastricht Treaty and solidified in the Stability and Growth Pact and, more recently, in the Fiscal Compact. Since 1992, the Commission has stuck doggedly to a doctrine of *'fiscal sustainability'* that obliges all EU states to reduce deficit and debt levels below thresholds of 3%/60% of GDP, levels insisted upon by German negotiators in the run-up to Maastricht (Leaman, 2012b: 232ff). In its conduct of fiscal governance, the Commission has focused almost entirely on issues of debt and expenditure, adopting in particular an additional threshold of debt (90% of GDP), beyond which economic growth was impaired; this threshold, based on the findings of Carmen Reinhart and Ken Rogoff (2010) appears again in the Commission's *Debt Sustainability Monitor 2017* (EC, 2018: 115, etc.), despite the fact that these findings were comprehensively disproved by Hearnden et al., (2013). The neglect of the category of revenue in the Commission's reviews of fiscal governance is thus crass and even measurable: in its *Fiscal Board Annual Report*, tax is mentioned a mere 19 times, debt 196 times and (budget) deficit 158 times (EC, 2017a). This is not a trivial oversight; it is echoed in the mainstream analyses of the IMF, for example (IMF, 2015).[8]

Fiscal 'sustainability' - essentially, simple compliance with SGP rules - is thus not an adequate measure of the quality of fiscal governance nor of the conduct of economic and social policy, especially in a political union marked by extreme divergence and committed to social and economic convergence and to 'smart' growth. Effective economic governance in such a union can only be ensured by a member state's fiscal '*viability*', i.e. its ability to fulfil the complex tasks of an advanced (capitalist) state, tasks that require the targeted deployment of shared, public resources. If one adds the specific and ambitious objectives of a pan-European programme of social investment to the equation, it is necessary also to assess the 'fiscal feasibility' of such a project. Currently, it is possible to talk about neither the fiscal viability of a significant number of EU states, nor of the feasibility of a programme of transformative social investment.

3.2 Social investment and Europe's tax realities

A cursory glance at the comparative statistics in this Report would confirm that the Baltic states with an average tax ratio that is 13.9 percentage points below their Nordic neighbours' average (see Figure 3.2 above), are fiscally vulnerable, and have been demonstrably less capable of (a) avoiding catastrophic recessions in 2008-9, (b) mounting effective reflationary programmes, (c) combating poverty and social exclusion and (d) preventing the dramatic wave of emigration by its jobless (younger) citizens (c.f. Leaman, 2018). The same applies to the Balkan group, whose average tax ratio (28.5%) is 16.1 percentage points lower than that of the Nordic group. This level of fiscal vulnerability perversely affects the capacity of countries like Romania and Bulgaria to receive Cohesion Fund monies, which are expressly designed to support weaker regions; their 'absorption capacity' is reduced not just by skill shortages among administrative personnel - as a deficiency in human capital - but by the simple requirement of Member States' 'match-funding' grant-allocations from Brussels with their own fiscal resources (see Katsarova 2013).[9]

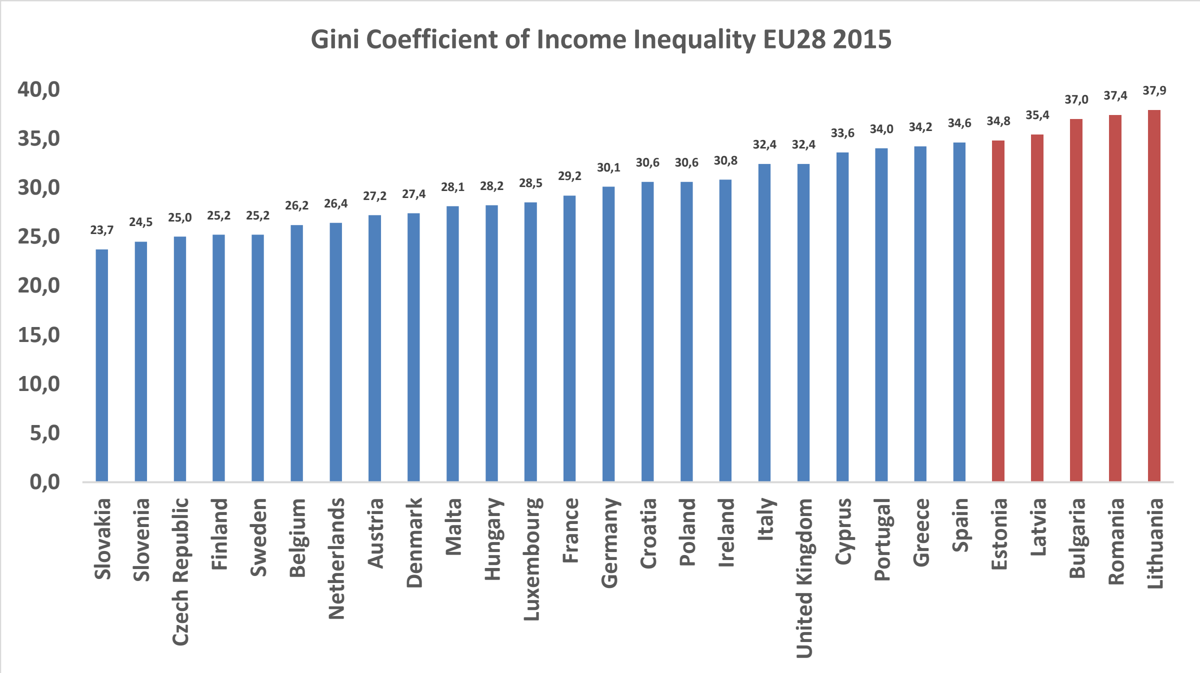
It is therefore no coincidence that the fiscally most vulnerable states also rank among the states with the highest levels of income inequality as measured by the Gini coefficient. While income inequality derives in large measure from the widening differentials of market income (before transfers), the (fiscal) state remains

8 In its Staff Note on *Reforming Fiscal Governance in the European Union*, the word 'taxation' appears not once, 'tax' a mere four times, 'debt' 136 times! (IMF, 2015).

9 Katsarova notes the paradox that 'the most disadvantaged regions also experience greatest difficulties in the absorption of funds. At the same time, they are the regions which need the greatest financial support for the restructuring of their economies' (Katsarova, 2013: 6).

critically important for ensuring both the regulation of employment and wages, and above all in the redistribution of national income through social expenditure on both income support transfers and on the wider field of social infrastructure. In this regard, the shape of the tax system is vitally important, above all in the ability of the state to create and maintain a *progressive system of income taxation*.

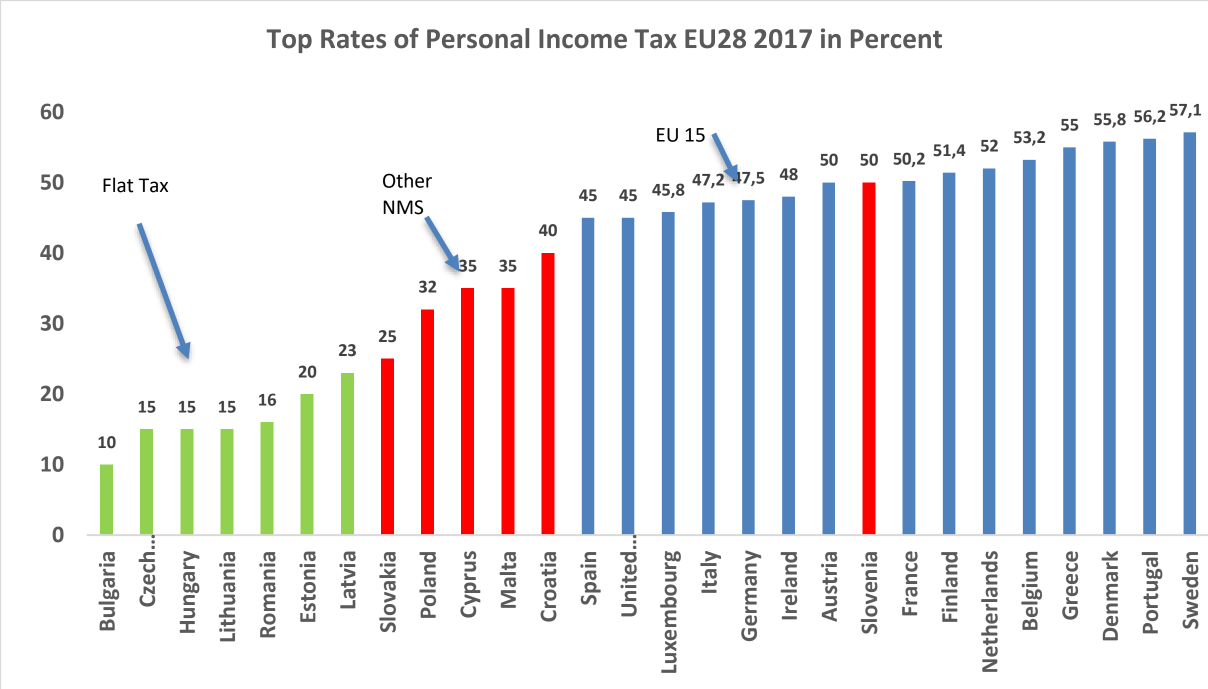
Figure 3.3 Lower revenues in EU Member States correlate with higher Gini scores



Source Eurostat

As noted above, the European Union - by default or by design - has tolerated the erosion of progressive income taxation in the region, thereby weakening the capacity of states to pursue progressive welfare reforms, as implied by the concept of social investment. Again, the disparities between EU Member States are crass (Figure 3.4).

Figure 3.4 Tax asymmetries in direct taxation

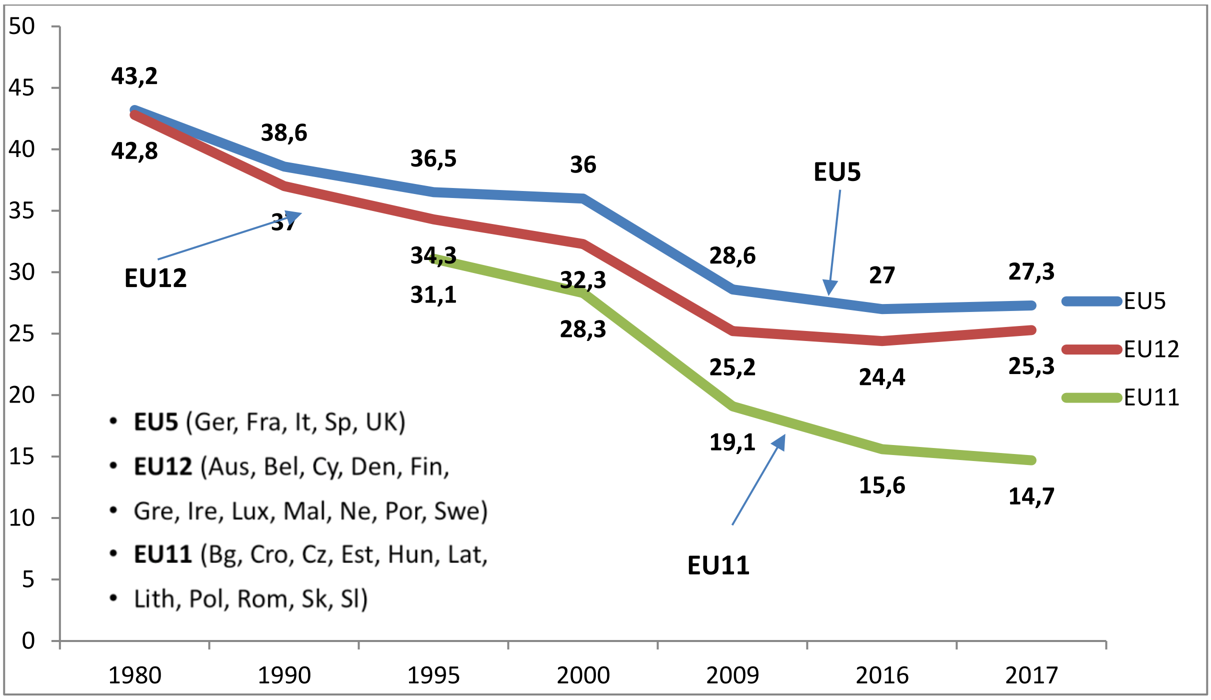


Source Eurostat; New Member States (2004) (et seq.) in green and red; EU15 in blue

Even more subversive in effect was the toleration of drastic cuts to (top) rates of Corporation Tax in the CEECs, where the gradual fall in rates since 1980 was accelerated by the emergence of real competition between the tax jurisdictions of the enlarged EU (Figure 3.5). This was driven, above all, by the extreme mobility of corporate capital since the abandonment of exchange controls in the 1980s and the anomalous facility of corporations to register their profits in a jurisdiction with lower CT rates. Figure 3.5 underscores the trend with data on three distinct groups of states, in particularly inferring a greater need for less developed EU states (EU12) to attract international capital. The trend is also indicative of the erosion of progressivity in taxation, given that the main beneficiaries of corporate profits are wealthier individuals with share portfolios.

Certainly, the tax policies in newer EU Member States are explicable, firstly in terms of the absence of anything resembling a 'Marshall Plan' for post-communist states (Ivanova, 2007), secondly because of subsequent dependence on imported private capital for modernisation, thirdly because of the dominant neoliberal faith in the ability of markets rapidly to resolve the modernisation problems of transition states. This still does not excuse the permissiveness of the Commission and key Member States in tolerating the destructive chaos of tax competition for all Member States, and the specific fiscal weaknesses that low-tax, flat-tax countries are currently encountering; it is this toleration that is culpable, not the strategic choices of weaker Member States.

Figure 3.5 Falling trend of rates of corporation tax in Europe 1980-2017



Source Eurostat 2017; own calculations; figures show percentage rate levied on taxable profits

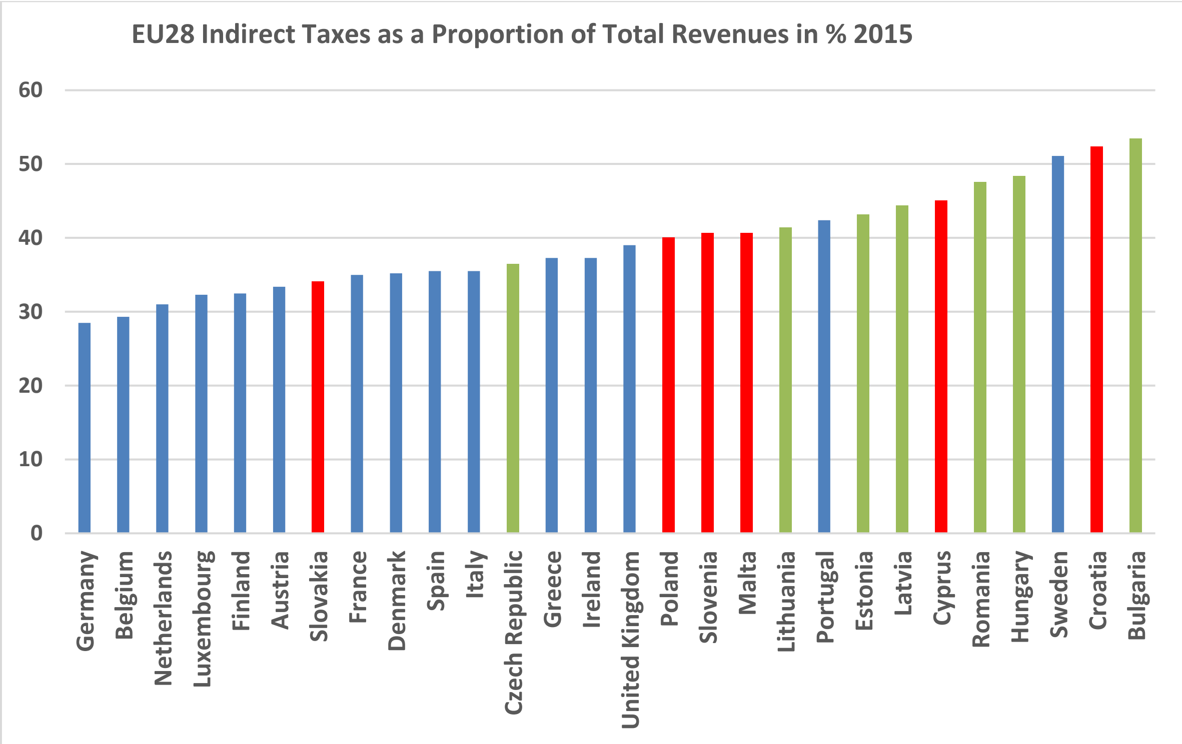
The critical erosion of progressivity in tax affairs is also evidenced in the increasing dependence, particularly of newer Member States, on indirect taxation on consumption (see Figure 3.6 below), which has a strongly *regressive* effect on income distribution (Decoster et al., 2009; Leaman, 2012a; see also EC, 2006: 11f), since poorer households spend a far higher proportion of their disposable income on goods and services. This contrasts with the greater propensity to save on the part of higher-earning households (EC, 2006).[10] The shift towards a higher reliance on taxation on consumption in the whole of the EU and the OECD (OECD, 2017: 13) was explicitly justified in terms of the assumption by Guy Verhofstadt (2005) that such a shift would stimulate higher levels of real growth[11] - a claim which is demonstrably unsustainable, given Europe's continuing growth problems.

Verhofstadt notes the weaker GDP and employment record of the Eurozone between 1992 and 2002 compared to the USA, a gap that was set to widen according to the OECD. Verhofstadt's faith in the benefits of supply-side reductions in rates of direct taxation and increases in VAT were arguably entirely misplaced; while average rates of VAT in the Eurozone rose by 2.3 percentage points between 2002 and 2017 and (top) rates of corporation tax fell by 6 percentage points in the same period, the average growth-rate for real GDP slid to 1% in the Eurozone and 1.3% in the EU28. Yes, Europe was affected very severely by the global financial crisis, but it has remained the weakest world region for GDP growth for three decades now. Two key factors in this process, as this article has sought to illustrate, have been the dogged pursuit since 1992 of budgetary austerity and the anarchy of tax competition; i.e. negative fiscal harmonisation in the shape of public debt and borrowing limits, but accompanied by the *destructive non-harmonisation* of taxation standards.

10 The regressive nature of indirect taxation is underscored by the widespread practice within the EU of imposing VAT on food and other basic necessities, albeit at a generally lower rate than standard VAT rates. The UK is one of the few states to exempt food and children's clothing from VAT levies.

11 Verhofstadt talks of the need for a 'massive shift' (2005), asserting against all the evidence that indirect taxes 'have a redistributive effect comparable to that of direct taxation'!!

Figure 3.6 Divergent dependence on indirect taxation in the EU



Source EC: Taxation Trends in the European Union (2017)

While there have been a number of initiatives, emanating in the main from the European Parliament, in relation to the transparency of corporate taxation (the Common Consolidated Corporate Tax Base - CCCTB; Country-by-Country-Reporting - CbCR; Base-Erosion and Profit-Shifting - BEPS) - the toleration of widely divergent tax rates and tax cultures (7 states with flat-tax regimes,[12] 21 with varied regimes of progressive taxation) presents a colossal obstacle to the general progress of the European Union and, above all, to the prospects of an effective system of Europe-wide social investment.

12 While the Slovak Republic has reverted to progressive income taxation and Germany's CDU abandoned its brief flirtation with flat tax ideas in 2005, Italy's incoming populist government (as of June 2018) is reported to be considering the introduction of a flat tax regime for PIT; Italy is not likely to face opposition from the Commission.

4. The need for convergence

From the above analysis and from earlier reports (Leaman, 2017), some clear conclusions can be drawn concerning the main obstacles to an effective roll-out of social investment programmes within the European Union. These can be summarised in terms of:

- general developmental indicators: there is a robust correlation between national economic productivity (GDP per capita or per member of the workforce) and levels of social protection, or the level of priority given to promoting social inclusion (c.f. de la Porte & Jacobsen, 2012);
- there is a strong correlation between the size of the state (qua tax and expenditure ratios) and the preparedness/ability to fund socially progressive policies;
- the ability of the fiscal authorities to effect meaningful redistributional social policies is hampered by tax systems that are not based on progressive income tax arrangements and are subsequently reliant on regressive indirect taxes on consumption;
- there is a correlation between market income inequality (before tax and transfers) and any state's ability to promote social inclusion (Leaman, 2014); the higher the level of market income inequality, the more intractable becomes the dilemma of state welfare policy;
- there is a consensus concerning the falling labour share in national income (Stockhammer, 2013; Piketty, 2014; OECD, 2015) in advanced economies, notably in Europe;
- there is a correlation between fiscal conservatism - institutional/constitutional obligations to limit the fiscal flexibility of the state - and weak domestic demand, notably the decline in the investment ratio; i.e. there are negative multiplier effects of state fiscal retrenchment overall and particularly during cyclical crises; this in turn limits the latitude for redistribution;
- there are distinct ideological/attitudinal features in individual Member States which affect the shaping of social policy and the priority given to redistribution; there is empirical support for the grouping of states in terms of the roughly defined clusters above (de la Porte & Jacobsen, 2012; Delhey, 1999) which range from strong acceptance of active redistribution policies (Nordic cluster) to lower levels of sympathy towards the poor and marginalised (Anglo-Saxon, Baltic clusters). These attitudinal features are demonstrably subject to 'events' and to the influence of print, broadcast and social media;
- there is strong evidence from recent economic and political events of divergence and fragmentation rooted in the disparate results of both secular economic developments and associated political attempts to manage these events: transition, modernisation, systems of governance, innovation, cyclical and structural crises.

From this diagnosis of the obstacles to a (transformative) programme of social investment, there would follow a set of recommendations. These have been well signalled by the above analysis and by earlier reports but can be summarised under the heading of *convergence*. For a cooperative, cross-national programme of social investment to thrive, it is *arguably essential for key indicators of macro-economic and macro-social performance to converge towards a best-case norm*:

1. Per capita GDP in the weaker peripheral states (Balkan, Baltic, Southern Periphery) needs to be raised towards an EU standard, represented by a much narrower disparity between highest and lowest levels, notwithstanding outlier small states like Ireland and Luxembourg; this would accord with the core

objectives of the Rome Treaties (c.f. Preamble)[13] and with those of EU Regional Policy.[14] While the EU's weakest states (by per capita GDP) - Rumania and Bulgaria - have exhibited a partial narrowing of the disparity to the EU28 average, the number of EU economies achieving GDP per capita scores below the average has increased from 15 in 2002 to 17 (almost two thirds) in 2016 (see Table 3.1); in 1958 disparities were much narrower with only Italy and Netherlands scoring below the average for the group of 6. The latest data suggest a regression of the Southern periphery (Spain, Portugal, Italy, Greece AND Cyprus), which represents a reversal of the pre-crisis process of convergence with the EU-average:

Table 4.1 Per capita GDP in southern periphery economies

	2002	2007	2016
Cyprus	89	101	81
Greece	90	96	67
Portugal	80	83	77
Spain	101	103	92
Italy	113	108	96

Source Eurostat

2. The very slow recovery from the 2008 crash suggests both lower trend growth for the whole of the EU and clear disparities in the growth trajectories of individual states. There is a clear danger of further *divergence* (not convergence) and subsequently of politico-economic fragmentation if such disparities are not addressed. Given the agreed reduction in national contributions to the current MAFF, the prospects for achieving macro-economic convergence in the medium term are currently poor.
   The objectives of both the Lisbon and Europe 2020 strategies of 'smart growth', rooted in innovation and higher levels of skill, need to be subsumed under the imperative of convergence (as above) by prioritising public (and private) programmes of investment in peripheral states, driven *by higher overall investment ratios*, but promoting *even higher IRs in weaker, less developed European economies*. Even in the decade of stagflation (1975-86), EC states managed an average IR of 25.6% of GDP; currently, most of the transition CEE economies have IRs below the EU average (20.1%); many have shown dramatic declines in investment since the Great Crash. More worryingly perhaps, the Southern peripheral states have chronically weak IRs, averaging 16%, below the UK's poor (and declining) level of 16.7%. Greece - with 11.4% - would seem to demonstrate the destructive futility of Troika austerity politics.

13 The Rome Treaties committed signatories to 'reducing the differences existing between the various regions and the backwardness of the less favoured regions'; http://www.hri.org/docs/Rome57/Preamble.html

14 The ERDF aims to strengthen economic and social cohesion in the European Union by correcting imbalances between its regions; http://ec.europa.eu/regional_policy/en/funding/erdf/

Figure 4.1 Gross fixed capital formation as a percentage of GDP in the European Union, 1970-2015

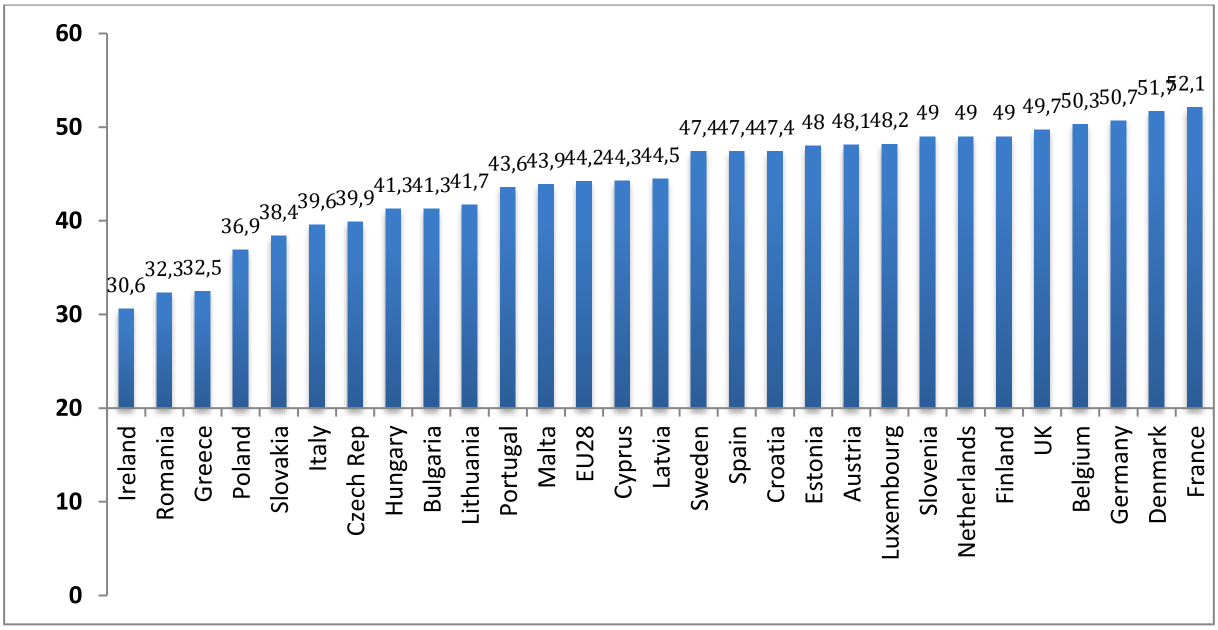
Source World Bank

While Europe would want to avoid the dangerous 'overheating' evident in the gigantic Chinese investment boom - with an investment ratio over 40% of GDP in ten of the last 12 years - there is nevertheless a strong case for prioritising modernisation investments in Europe's peripheries in order to achieve IRs consistently above 25% of GDP; within that crude target, states would be encouraged/incentivised to favour innovative investment programmes involving social and environmental imperatives. In this context, the recent strong financialisation of investments (diversion from real value-enhancing investment to, at best, 'welfare-sterile' financial assets) needs urgently to be reversed (c.f. Christensen et al., 2015).[15]

3. Apart from critically vital 'smart' investments, other elements of domestic demand need to be restored to levels which ensure more dynamic domestic economies and a lower dependency on net exports as vehicle of 'smart growth'. In the first instance, the *declining wage share in European economies needs somehow to be reversed* to achieve functional distribution levels closer to those obtaining in the period prior to the neoliberal 'trickle-down economics' era (Figures 4.2 & 4.3).

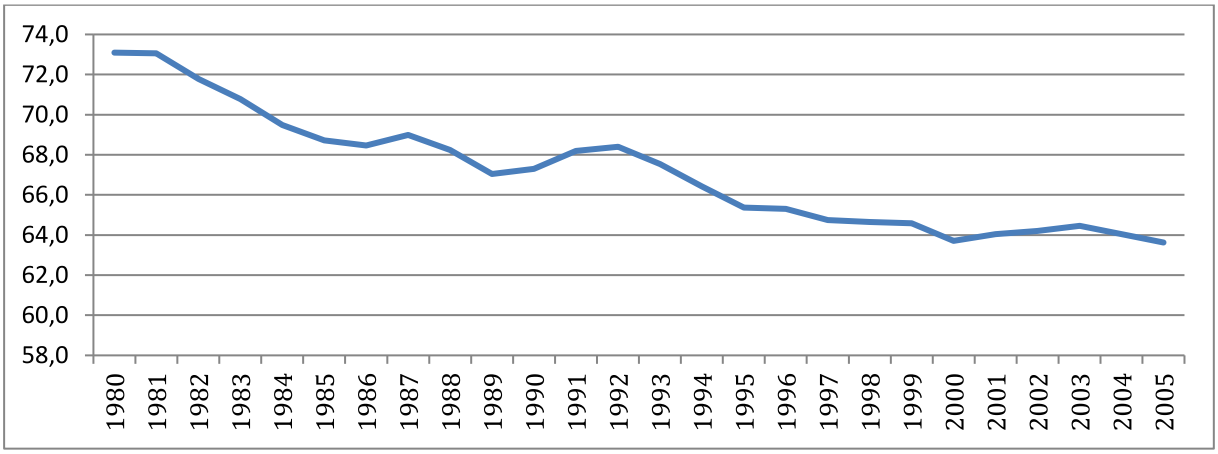
15 At worst, of course, financialisation has destroyed real value: through the neglect of socially and economically vital investments for human development, and through the squandering of existing capital resources (under-utilisation of industrial and commercial capacity) and the diversion of creative human talent (qua human capital) from welfare-enhancing economic activity.

Figure 4.2 Wage share of national income EU28, 2014



Source Eurostat

Figure 4.3 Adjusted wage share of national Income, Europe, 1985-2005

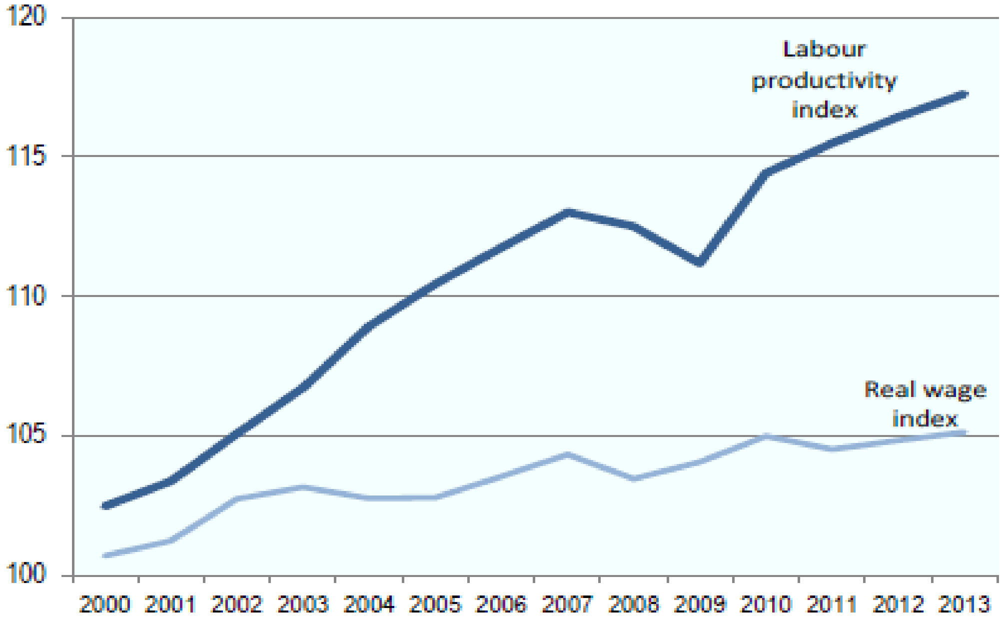


Source IMF

4. Notwithstanding the secular factors that have driven the overall decline in the wage/labour share (Stockhammer 2013; ILO/OECD, 2015; Haldane, 2015) - technological innovations, a multi-polar globalised economy - the (re-)deployment of labour power remains one of the core challenges for all states, but particularly those that are committed to an inclusive programme of social investment; it demands the elevation of employment policy to an unchallengeable centrality in a state's policy mix. Reversing the downward trend in the wage share, however difficult that task may appear, makes eminently good macro-economic sense, not the least because mainstream economists over the last 40 years have 'got it wrong'. The essential failure of 'trickle-down' permissive neoliberalism is to be found in the assumed benign effect of boosting the profits ratio at the expense of the labour share; however, a *higher profits ratio did not generate a higher but a lower investment ratio*, as evidenced in Figure 4.1! It did, however, generate a *colossal displacement of corporate reserves away from real investment towards financial assets*, for the simple reason

that the trend of a declining labour share weakened the potential growth of domestic demand for real goods and services. Real wage growth generates overall endogenous growth and encourages investment, particularly when it is justified by higher per capita output. This brings us to the second key factor in the distortion of wage-setting, namely the *divergence between rising labour productivity and stagnating real wages* (Figure 4.4).

Figure 4.4 The divergence of labour productivity and real wages



Source OECD (2015)

This anomaly needs to be rectified; the egregious practice of 'wage dumping' - notably by Germany in the last two decades - has to be eliminated. Thirdly, the *chronically low wage share* of the working populations of Ireland, Romania, Greece, Poland, Slovakia and Italy e.g. (Table 3.1 above), needs to rise to generate additional domestic demand both nationally and Europe-wide.

5. Reducing the inequalities of the functional income distribution within and between countries (wage & profit ratios) would need to be matched by a *downward convergence of personal income inequalities* (qua Gini coefficients) to levels obtaining in the best performing advanced economies (Nordic Group) and the best performing group of newer Member States (Core CEE group). There is robust evidence for economies with narrower income disparities manifesting better sustainable growth and social cohesion over time (Pickett & Wilkinson 2009).[16]
6. The domestic demand generated by the state (public sector) via the provision of public goods (in the broadest sense) is critical for the realisation of meaningful social investment. There is consequently an urgent need for *radical upward fiscal convergence* within the Union of European states, as noted above; while there are clear indications of partial convergence in terms of accounting standards, transparency, base erosion and profit-shifting, there are key and persistent asymmetries in the fiscal cultures of the EU28 which threaten to exacerbate the ongoing process of fragmentation within this crucial group of advanced states.
7. Funding social investment: Setting aside notions of private/corporate involvement in funding social investment - via privileged bond issues, etc. - we must start from the assumption that *the primary route to*

16 Pickett and Wilkinson note in particular the 'pernicious effects that inequality has on societies: eroding trust, increasing anxiety and illness, (and) encouraging excessive consumption'.

the adequate and sustained funding of comprehensive programmes of social investment is that of collective, democratically answerable fiscal responsibility. The political governance of social investment may be/will be multi-layered (local, meso, national, supranational) but civilised social investment - as a process of targeted allocation of social resources in the shared common interest of all citizens is inconceivable either in a privately owned and managed, hierarchical business or in an autocratic political dictatorship. These variants of feudal governance are incompatible with the inclusive, collective promotion of individual capabilities and the 'social capital' in which it is rooted.

5. Towards a common fiscal policy in the EU

The fiscal dimension is thus central to the successful implementation of a regional (European) programme of economically and ecologically sustainable social investment. If *social disinvestment, poverty, marginalisation* are the evils to be avoided or reversed, socially inclusive sustainable growth with strong intergenerational commitments has to be the primary macro-policy – economically, socially and politically.

This demands a strong focus on *fiscal viability* and a radical modification of the EU's concept of fiscal sustainability qua *fiscal rules* (Leaman, 2016). If society cannot, above all, afford to preside over economic and social disintegration, then it must devise effective fiscal and governance mechanisms to realise its policy goals, above all those of *convergence* and *cohesion*.

The 28 states of the EU region must set appropriate allocatory priorities on the basis of shared commitments, common fiscal standards and equity. This indispensable foundation of cross-national, EU-wide social investment is barely discernible in 2017. In particular, critical elements of fiscal viability and multilateral fiscal responsibility are absent.

Tax ratios and the role of the state need to be reconsidered. The wide disparity between the tax ratios of the fiscally weak EU states (Baltic and Balkan groups) and the major economies of the old EU15 (Austria, Belgium, Denmark, Finland, France, Germany, Netherlands, Sweden, UK) needs to be narrowed (c.f. Figure 3.3 above); an upward convergence of such ratios to a level which ensures the public fiscal viability of states committed to 'smart' development and the reduction of social inequalities is essential. The MS occupying the lower end of the tax ratio scale in Figure 3.3 are, or have become, less viable fiscally because they do not command sufficient revenue resources both to sustain medium- and long-term economic development strategies and to respond to exogenous shocks; they are arguably vulnerable in both structural economic and cyclical terms. This is demonstrated in part by their heavy dependence on imported capital to fund core features of their physical and social infrastructure; this is particularly the case for the Baltic states and the other CEECs which dominate the lower end of the scale.[17]

Destructive Fiscal Rules must be Revised. A key factor in this weakening of fiscal viability is the general ideological priority given to narrowly defined 'fiscal rules', as expounded by Reinhart and Rogoff (2011) with their (demonstrably false) assertion of a tipping-point for state debt beyond 90% of GDP; secondly, the institutionalisation of these arbitrary fiscal rules in the Maastricht Treaty, the Stability and Growth Pact, the Fiscal Compact and in the legal statutes of several EU-countries has undermined the ability of states to manage economic development (Chowdury, 2012) and, in particular, weakened the image of public authorities as effective agents of economic activity (c.f. our debate on 'trust' in political institutions). The general process of weakening the state has been given further impetus by the mantra-like repetition of the statement by the Commission that the EU is a region with higher tax ratios than any other world region.[18] The deafening silence on the part of the Commission and the Customs and Taxation Directorate on the indispensable value of tax revenue for maintaining social and economic welfare ('the price we pay for civilisation' according to Oliver Wendell Holmes) is, in this context, culpable. There is also some evidence for the Commission's (tacit) complicity in undermining the role of the taxation state in its toleration of egregious tax reforms in the newer Member States of central and eastern Europe, most notably flat taxes. In this political

17 It is also a noticeable feature of the political economies of Ireland the UK, whose tax ratios have fallen, while their reliance on external funding of key projects has grown.

18 This statement appears in the opening paragraph of the preamble to every annual report on Taxation Trends in the European Union from 2010 onwards!!

atmosphere of permissive tolerance towards aberrant tax regimes but punitive intolerance of deficit and debt infractions, fiscal viability has been serially weakened (Leaman, 2012a: 157ff). In particular, the flattening of the curves of progression in those EU states with progressive systems of income taxation has weakened all states' ability to enact progressive, redistributive social policies. This process has to be reversed, *the principle of progressive income tax has to be made mandatory for all Member States of the EU* and the fiscal resources of the weaker states have to be boosted by appropriate changes to their tax systems and tax cultures. Failure to achieve this leaves ALL Member States vulnerable to tax arbitrage pressure from mobile corporations.

Consequently, the CEECs with systems of flat taxes (single-rate proportional levies on taxable income) have to be encouraged/incentivised to (re)introduce progressive systems of income tax with curves of progression similar (if not identical) to those obtaining in the old EU15; a harmonisation of tax systems, involving a convergence of marginal rates at both the lower and higher ends of the income scale and a closer alignment of tax allowances for both households and businesses would be an important first step in a - for certain CEECs - radical transformation of the state's ability to raise revenues and deploy those revenues effectively. Because of the divergences in GDP per capita, EU Member States - via ECOFIN - would have to agree to both *slightly lower levels of capital and income taxation in weaker states to ease the transition to fiscal viability* (c.f. Leaman, 2016); this specific process of promoting the modernisation of fiscally weaker Member States should be accompanied by a closer harmonisation of tax cultures across the whole Union, firstly to *prevent destructive tax competition between Member States* ('divide and conquer' tax arbitrage tactics by TNCs) and to reduce the contradictions between top marginal rates for Personal Income Tax and the (currently much lower) standard or top rates for Corporation Tax; this in turn would remove the incentive for SMEs to 'incorporate' (c.f. Leaman, 2012a: 164f);

The strengthening of progressivity would, of itself, increase the revenue share of direct taxes; however, Member States should be encouraged to reduce the regressive effect of a still excessive dependence on indirect taxation, for example through a stronger differentiation of taxable goods and services, favouring basic commodities and services with socially and environmentally progressive functions (children's clothing, housing, education, health, renewable energy, decontamination, bio-diversity); this does already apply, albeit marginally, in some states, notably the Baltic states.

Narrowing the divergence of tax and revenue cultures would, in the medium term, still leave weaker jurisdictions less well placed to promote both overall development and, above all, social investment. There is consequently a very strong case for strengthening/deepening the fiscal arrangements of the Eurozone and the wider EU to *increase markedly the resources available through the Structural/Cohesion Funds*. The allocation of enhanced funding for poorer states/regions, for example, could reasonably be conditional on the implementation of progressive social investment (and green) programmes; these in turn could be subject to compliance procedures with at least as much leverage/compulsion as the rules governing state deficit and debt ceilings. Given Barroso's candid observation that annual tax evasion in Europe amounts to some six times the EU's total annual budget, noted above, the latitude for vertical and horizontal fiscal equalisation within the EU is not inconsiderable - given a new and concerted effort to harmonise tax regimes and prosecute avoidance and evasion.

There is therefore an urgent need to promote a strong and sustainable convergence of levels of fiscal viability both via arrangements of vertical and horizontal fiscal equalisation (money transfers to weaker regions/political economies) within the EU28, and via collective liability for both short-term public deficits and long-term state debts, qua Eurobonds. Again, the issuance of Eurobonds could be made conditional on the targeted use of funds for the provision of vital public goods, including economic and social infrastructure and social investment.

Best practice in fiscal governance. The availability of such resources in sufficient quantities at the point of delivery is an essential pillar of subsidiarity and devolution and the active democratic culture that this should encourage. The challenge of social investment (or indeed of decent state governance of the economy) is to ensure continuity and predictability in the allocation of resources to both national ministries and, above all, to sub-central units of the state and civil society agencies. The evidence to hand, when correlated with the features of macro-economic imbalance discussed above, would suggest that best practice in subsidiarity is to be found in those states which facilitate the most generous revenue streams at sub-central level (OECD, 2007). In particular, Germany's federal system operates on the basis of legally fixed shares of major tax revenues (PIT, CT, VAT) for central, regional and local government; fiscal equalisation operates at all three levels, favouring fiscally weaker authorities. While centralised states in Europe operate their own systems of fiscal equalisation, the worst suffer from excessive levels of discretion for central finance ministries. This has been particularly the case in the United Kingdom which, in the name of New Public Management, has starved local authorities, reduced their access to locally levied taxes and charges and diluted the quality of public services. A short contrastive analysis of the operation of subsidiarity in Germany and Britain might be an instructive addition to a project devoted to effective social investment.

However, any such analysis would have to acknowledge both the severe deficiencies in infrastructural provision in Germany and the increasing restrictions imposed on sub-central government as a result of the specific fiscal limitations now enshrined in the so-called 'Debt Brake' and the invocation of the 'schwarze Null' (balanced budgets in the medium term) as a badge of fiscal honour. There is growing evidence that this ideological fetish (akin to the deficit and debt strictures of the Eurozone) is destructive of long-term sustainable growth (Haffert, 2016)

Further areas to explore within discussions of social investment in Europe include the development of strengthened institutional channels for the transmission of both resources AND ideas. Secondly, to explore innovative systems of funding for social investment, including hypothecated insurance or tax contributions; tax-incentivised social investment bonds, even if these remain secondary to the public sector's responsibility to fund and manage social investment. Thirdly, to explore the macro-economic relevance of housing, employment, training and education for effective social investment, and to identify both critical contrasts between Member States/groups of states and best practice.

6. Conclusion

Social investment is not feasible without a 'social investment state' (Famira-Mühlberger, 2013). A state that promotes social investment as a primary policy objective needs above all to be fiscally viable. Fiscal viability - the ability to cushion both recessionary shocks and to ensure the long-term social security of a state's population - demands a stable, thriving economy, from which the state can expect to command a tax ratio closer to the Nordic average, i.e. above 40% of GDP. Social investment requires both a progressive system of taxation and a tax culture which acknowledges the economic and social benefits of tax fairness and fiscal redistribution. Furthermore, fiscal viability within a multilateral framework of pan-European social investment requires an extensive degree of harmonisation in fiscal affairs.

This part of the report has sought to demonstrate that the preconditions for such an effective programme of social investment do not currently exist within the EU. The ideological disorder of neo-liberal supply-sidism continues to dominate the thinking of key elites within the EU - at the level of the Commission, the European Central Bank and Germany's Grand Coalition. Without a very significant increase in fiscal resources Europe-wide - at national and at EU-level - Europe's macro-economic disparities will hinder the realisation of the SIP's core objectives. The (slow) progress that has been made on improving the transparency of tax affairs in the region is simply not enough to halt the region's destructive tax competition and establish the levels of progressivity that are essential for a halfway adequate programme of social investment.

Fiscal redistribution via a social investment state is, however, only one vehicle for addressing the severe problems of inequality, poverty and arrested development in Europe. There are notably two essential pre-conditions for a transformative resolution of the current disorder in Europe's economic and social affairs. The first is to achieve significant reductions in the primary distribution of national income, i.e. of 'market income'. A narrowing of the pattern of wage and salary differentials ('market Gini') via legislative controls of wage- and salary-setting will ease the task of achieving a lower net Gini coefficient after fiscal redistribution measures. The second additional pre-condition is to underpin social policy initiatives with a powerful *narrative of social justice and cohesion*; the established welfare states in Scandinavia continue to enjoy the support of civil society, even if the party-political landscape has shifted selectively towards a right-wing agenda. This social justice narrative cannot be imposed on civil society from above; it requires above all strong levels of codetermination at the local and micro-level within a framework of subsidiarity and fiscal equalisation. The admirable principles of the EU's regional policy need to be underpinned by both a significant increase in resources, targeted at the neediest regions, local authorities, civil society organisations and their target communities, and by legally fixed allocations of revenue for sub-national levels of the state, which allow the long-term planning of social investments.

The new narrative of social justice and legitimate social rights must thus be informed by the voices of citizens' groups, by their perceptions of housing, social care, education, training, health, basic utilities, policing and safety. It is not sufficient to repeat academic evidence on the negative consequences of inequality and how 'equal societies almost always do better' (Wilkinson & Pickett 2009), however persuasive that evidence is. Rather, the ownership of that perception by a good majority of citizens - as a reason for 'celebration' (Murphy) - is essential for the acceptance of long-term, cross-border and cross-generational programmes of social investment. In the short term, a shared narrative of social justice as a public good is also vital to challenge the hegemony of disorder, of permissive liberalisation, its institutions and its policy myths (Leaman, 2018a).

Part 2:
Transformative social investment: towards the re-evaluation of human, social and natural capital – a fiscal perspective

The concept of social investment allows two key semantic interpretations:

- investment in the institutions and capabilities of citizens of a society, defined by an identifiable jurisdiction; societal investment;
- collective expenditure in the shared physical and normative relationships which are the pre-conditions for the sustainable functioning of a society based on human welfare, social cohesion, intergenerational justice and planetary survival.

The joint meaning is inescapable: collective responsibility for a set of public goods - tangible and intangible - linked to collective answerability to legally and ethically founded democratic and ecological checks and balances.

What the EU and an explicit body of supportive literature have chosen to conceptualise as a new programmatic policy area, does little more than describe the interdependence of policy in advanced political economies, an interdependence which has grown more complex and more financially demanding over the course of the history of the modern state. It reflects an increasingly refined conception of human and social development, as demonstrated by the UN Human Development Reports and statistical measurements (UN, 2018) and, specifically, by the World Bank's Human Capital Project (Gatti & Kraay, 2018). What is new is the laudable ambition to see the process of social investment rolled out at the European level, where Member States are encouraged to operate their social policies according to supranational shared principles, shared minimum standards and shared medium-term objectives, and - to a lesser or greater extent - shared resources.

So far, so good. However, the way such shared ambitions are realised is crucially dependent on the intellectual or ideological points of departure of European policy-makers or of their advisory think-tanks collectively. The authors of this report on the macro-economic and macro-political pre-conditions for an adequate realisation of pan-European social investment proceed from a reasoned and evidence-based primary assumption that the planning, resourcing and administration of social investment should be a public sector responsibility. We need to 'rediscover the state' (Hemerijck, 2012: 51), or fashion a 'courageous state' (Murphy, 2011). A further point of departure is the conviction that the governance of this multi-level programme, incorporating supranational, intergovernmental, national, regional and local public institutions should operate according to the subsidiarity principle as both the appropriate vehicle for optimal policy-formulation, and the political activation of representative civil society and community actors in key processes of designing and delivering social investment projects. The importance of 'bottom-up' conception and fine-tuning is in turn dependent on a shared long-term vision between communities and stakeholder groups at the bottom and political and social agencies at central and regional level; a key component of this vision has to be a commitment to narrowing the disparities of distribution (income, wealth, access to health, education, employment, housing, water) as a means of neutralising the current levels of mistrust and resentment towards political and economic elites (c.f. Sabel et al., 2012)

7. Contextualising social investment in the macro-economy

Social investment is, by definition, a continuous process rooted in the commitment by successive generations of policy-makers and members of society to the long-term sustainability of *welfare, social cohesion and the living environment as public goods*. The process has altered and will continue to alter over time, under the influence of changing patterns of economic and social reproduction, demography, technological advances, consumption patterns, income- and resource-distribution, endogenous and exogenous shocks and countless other determinants. Moreover, it is the complex interactions of these changing patterns at national and global level that determine the many outcomes of the process, which in turn require sophisticated and integrated policy responses at all levels, but in particular at the level of local communities and their physical and social infrastructure.

> *'From urbanisation to the creation of jobs for millions of people, the world's challenges will only be solved using approaches that take both complexity and local context into account.'* (UN, 2018: iii).

To take just one of many examples, the shifts in the sectoral distribution of economic activity, investment and employment - from primary (agriculture, fisheries, raw materials) through secondary (industrial and artisan manufacturing) to tertiary (education, health, transport, finance, security) sectors over the last two centuries - has generated a constantly changing set of challenges for public authorities and for members of society relating to the very foundations of social existence (Wren, 2017: 97ff). The fundamental shift in the circumstances of all individuals and households in the advanced political economies of Europe and other OECD countries within three or four generations is dramatically self-evident: longevity, livelihoods, income-source, living space, household equipment, transport, leisure, tourism, mobility, communication - the list is endless. The key observation here remains the relentless continuity of social policy as investment in sustainable, democratically legitimated social relationships, policy which in turn is subject to relentless processes of change.

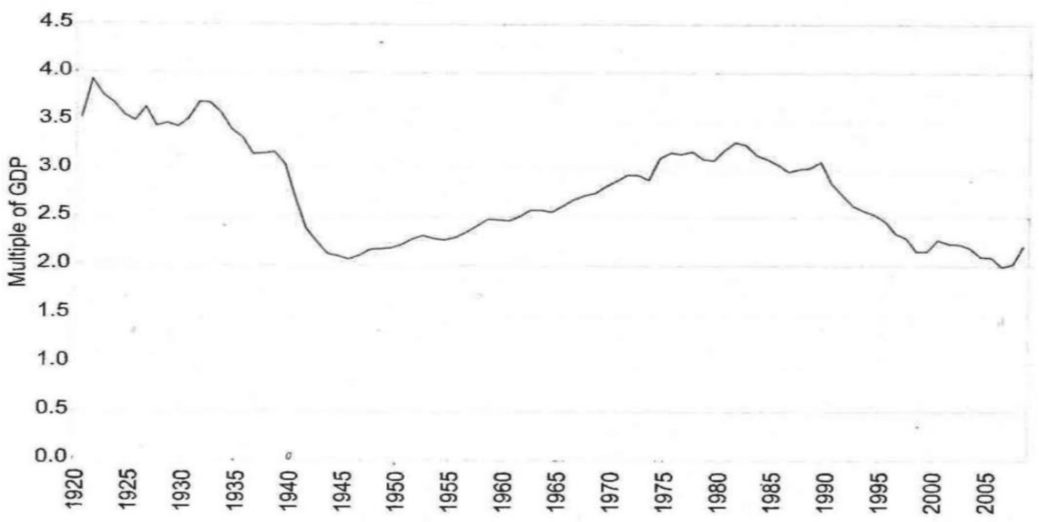
The strategically vital role of social investment is thus characterised by commitments that go way beyond the limits of legislative periods and the whim of party-political preferences. To be sustainable, any such investment must be rooted in the norms of behaviour and discourse akin to the Charter of Human Rights and supported by legal statutes. However, in contrast to the unbending codes of the UNCHR, the changing circumstances of political economies and societies demand a flexibility of both public policy-responses which is actively supported by a trans-generational social consensus. The model status often credited to Scandinavian social democracies of this very kind of consensus has, nevertheless, been seemingly weakened by several factors, including the effects of intra-European migration and overseas migration, in large measure drawn by the region's reputation as generous and inclusive welfare state as 'pull-factors'. This underscores the vulnerability of even the best-rooted state- and welfare-narratives to endogenous and exogenous shocks. Resilience to such shocks has, therefore, to be built into any supra-national programme of social investment. It is the firm contention of this report that such resilience has to be founded on an actively nurtured set of behavioural norms among the populations of states (and groups of states) which prioritises the welfare of all and the responsibility of collective (shared), public agencies for such welfare; above all, this must be *explicitly* counterposed to a political philosophy that asserts - in its extreme form - the non-existence of 'society' and seeks to reduce public responsibility for social and economic affairs (Thatcherism, neo-liberal supply-sidism). One of the main challenges for advocates of sustainable social investment thus remains the promotion, nurturing and maintenance of core, shared values of social coexistence which replace the destructive values of parasitic rent-extraction (Mazzucato, 2013, 2018; Foroohar, 2017, esp. 179ff), and allow for reflective responses to changing circumstances.

However the metaphor of social investment is turned, it implies expenditure by (socially active) agencies with identifiable benefits/'returns' for the welfare of the population of a jurisdiction, which result from testable processes in which the allocation of financial and human resources generates a self-reinforcing dynamic of welfare improvements.

From a macro-economic perspective, the particular urgency of public investment, including social investment, in the current extended period of financialised capitalism can be seen in the statistical evidence of both declining investment ratios in the region (see Figure 4.1 above), notably among advanced economies, and of the declining net stock of produced wealth (total national assets) expressed as a multiple of GDP (Figure 7.1).

The average investment ratio for the European Union has fallen from some 24.8% of GDP (World 26%) in 1980 to 20% in 2016 (World 23.2%), where the disparity with the world average has widened from 1.2 to 3.2 percentage points.[19] Figure 7.1 shows data for the United Kingdom which can act as a rough proxy for the rest of the region, where the value of national assets (produced wealth as a multiple of GDP) declines predictably as a result of the under-investment of the Great Crash period and the physical destruction of the Second World but recovers after 1945 to the early 1980s, after which the multiple declines again through the following four decades.

Figure 7.1 Produced wealth in the UK as a multiple of GDP



Source Martin Weale (2012: 62)

This represents an extreme example of a general trend in the political economies of western Europe, a trend that coincides with the ascendancy of neoliberal supply-sidism and the financialisation of capitalism. Apart from the consistent fall in the proportion of national product which is reinvested in the productive capacities of economies, the period is characterised (a) by the sweating of assets by private corporations marked by high market shares of a monopolistic or monopsonistic nature, (b) a rise in the profit ratio/profit share of national income and the corresponding fall in the wage share and, most importantly, (c) the emergence of a

19 Within the EU average, national performance varies considerably with particularly chronic levels of the IR in 2015 for Greece (12.6%) and the UK (16.9%).

colossal and growing volume of financial instruments and assets, the market for which absorbs both the 'homeless' reserves of capital created by (b) and the new money created by the ballooning of private debt and the disempowerment of central banks as managers of the money stock. Mary Mellor (2010) talks of the 'privatisation of money', Ann Pettifor (2017: 9ff) identifies the transfer of 'control of the public good that is the monetary system to private wealth', allowing the emergence of 'liquidity factories' (Phillips, 2008), dominated by private financial institutions. Cédric Durand describes the paradox of declining levels of national wealth and rising profits in terms of an 'enigma of profits without accumulation' (Durand, 2017: 119ff)

Elmar Altvater, the Berlin political economist, described this process as the 'decoupling' (Entkopplung) of the financial services sector from the real economy (Altvater 1991); the historical auxiliary status of banks and other financial institutions which *service* the needs of productive and commercial enterprises as intermediators, is accordingly transformed into a self-referential set of parasitic relationship involving myriad speculative bets on the future prices of financial assets. Pettifor characterises the process in strong political terms.

> *'Monetary systems and financial markets have been cut loose from the ties that bind them to the real economy, and to society's relationships, its values and needs. That is largely because monetary systems have been captured by wealth elites who, with the collusion of regulators and elected politicians, have undermined society's democratic institutions and now govern the financial system in their own narrow and perverse interests.'* (2017: 9). *'Casino Capitalism'* (Minsky, 1992, Strange, 1997, Mazzucato, 2018: 135ff) *not only absorbs the liquid reserves of non-banks, but also the additional liquidity provided by bank debt-facilitation.*

Apart from significant growth in the sheer size of the financial services sector as a proportion of economic activity in the world's major economies, the new asymmetries of financialised casino capitalism are most crassly illustrated by the rise in the ratio of financial market assets to real assets in the balance sheets of companies in the real productive economy; this 'financialisation of non-financial firms' (Durand, 2017: 78) has been driven in large measure by the frequently higher rates of return achieved by an increasingly wide range of actors in the banking and shadow banking sector (Mazzucato, 2018: 142ff; Huffschmid, 2002: 22ff) and by the associated demands of major shareholders in 'non-banks/non-financials' for improved stock market valuations of their holdings in the short-term. The financialisation of German industry's traditionally conservative, long-term investment culture bears witness to this major shift in Europe's political economies (Leaman, 2009: 80f; 2014: 61). Jörg Huffschmid describes the emergence of these crass asymmetries as the 'deformation' of Europe's political economy (Huffschmid, 2002 & 2007) and supports this with scrupulously researched evidence from the major financial markets in equities, commodity futures, financial futures and currencies. In this context Marianna Mazzucato (2018, etc.) develops a broad but telling distinction between value-creation and value-extraction, where the bloated and self-referential financial services sector extracts value from transactions involving unreal/fictitious assets, but which also promotes a culture of short-termism in the broader economy which encourages rent-seeking, and which disincentivises innovation and long-term research, including innovations in the field of social investment.[20]

20 Cédric Durand (2017) describes the anatomy of 'fictitious capital' in a perceptive and persuasive manner; see also Paul Mason (2015: 19).

8. Conceptualising a social investment multiplier

The previous section sought to provide an understanding of the challenges faced by a programme of Europe-wide social investment, the institutions and the macro-economic processes that have shifted the whole environment of investment and which will continue to affect the programme's implementation. In particular, it tried to underscore the central role of the public sector (from supra-national down to local level) in providing the fiscal and other resources to drive the programme over an extended period of time, as well as establishing and maintaining a shared regulatory framework. Moreover, the comprehensive spatial responsibility of the public sector for the physical and social infrastructure of its jurisdiction in relative perpetuity also requires something akin to a 'normative infrastructure' that supports the maintenance of a flexible, responsive active social state, the nurturing of which must involve the participation of stakeholder groups and their broader communities (c.f. Morel & Palme, 2017). Inclusion is a pre-condition for long-term cohesion.

The concept of the *multiplier* was first introduced into macro-economic theory in the early 1930s, firstly by Kahn (1931) and then by Keynes (1936) in the context of recession and depression and in support of public works as an instrument of boosting economic activity and employment through fiscal policy, but also through monetary policy measures. The fiscal multiplier was intended to boost demand flows in the conventional circuitry of a macro-economy rooted in real investment, real production and commerce and real demand by private households and public agencies (state consumption). Fiscal stimuli operated via increases in state expenditure (direct injections of the fiscal resources of revenue and borrowing) and modifications to tax rates and tax allowances (indirect). Such stimuli sought to counteract cyclical and structural demand weaknesses, i.e. recessions and/or demographic/sectoral shifts. While both Keynes and Kahn acknowledged the disruptive dimension of finance capital, they assumed the receptiveness/ responsiveness of demand dynamics that would allow the appropriate stabilising anti-cyclical effects on aggregate demand. Speculation in financial assets was accordingly manageable, particularly in political economies with national controls on international capital flows (e.g. exchange controls).

The decoupling effects of financialised capitalism, noted above, pose distinct challenges to the roll-out of fiscal multipliers and imply additional costs which could partly neutralise the benign effects of state intervention in demand circuits. However, these costs in no way reduce the merits of state intervention and demand stimulation in periods of cyclical and/or structural crisis. Rather, they demand both the neutralisation of 'finance-dominated accumulation' (Stockhammer, 2007) and the more urgent public activation of effective demand circuits. The fortunes of the multiplier in economic theory have seen a relative revival, in particular in some of the erstwhile bastions of supply-sidism and monetarism (the institutions of the Washington Consensus: in particular the US Treasury, the World Bank and the IMF),[21] notably since the Great Crash of 2008. Nevertheless, the restoration of the multiplier to mainstream discourse remains a dangerously slow process, and the costs of its neglect are increasingly evident in Europe in particular.

Ann Pettifor provides an elegant and convincing account of the multiplier:

> *'There can be no denying it: the multiplier has a critical impact on the economy. New spending financed by public borrowing has a series of repercussions that ripple through the economy. Thanks to the multiplier, the aggregate impact of public spending can be far larger than the catalytic jolt of the original government borrowing and expenditure. So the direct effects of government borrowing and investment on, say, a wind farm will first benefit the companies that produce the relevant wind farm equipment,*

21 The European Central Bank and the Bundesbank remain committed to the tenets of the Washington Consensus.

their existing employees, and those who benefit from the new jobs created by investment in that industry. But the increase of employment doesn't stop there. There will also be a number of secondary repercussions. The extra wages and other incomes paid out will be invariably spent on extra purchases, which in turn leads to further employment.' (Pettifor 2017: 70).

A broadly conceived and integrated programme of social investment will operate in a less easily defined and quantified manner, but will still generate positive multiplier 'ripple' effects via a 'series of repercussions' activated by fiscal 'catalysts'. The extreme complexity of the multiplier ripples in a European social investment-programme - compared to the multiplier models associated with physical public works - is underscored by the number and diversity of over 130,000 administrative units which make up the central, regional and local authorities within the EU28 (see Table a1.2 in Appendix). The fiscal resource and administrative dimensions of social investment are, on this scale, complex enough, particularly given the variety of national and regional arrangements for allocating resources (central, federal), the levels of discretion at individual administrative levels and - not least - the wide disparities in the size of states/jurisdictions (Germany 80+ millions, Malta: 0.425 million). One must then add the different social policy fields that constitute the multidimensional programme of social investment to appreciate both the separate pathways down which the fiscal resources and their corresponding regulatory mechanisms must flow, as well as the necessary coordination processes between policy fields. The complex interdependence of the fiscal transmission processes must necessarily involve a holistic and collaborative approach to social investment. Hemerijck rightly stresses the 'crucial' need 'to consider the 'fine' structures of the welfare state' in the roll-out of an integrated programme of social investment (2012: 49), i.e. maximising the benefits of social policy as a 'productive factor' but also promoting the synergies between the separate policy fields, e.g. education, health, housing, employment and income distribution.

9. Fiscal transmission process

There are fundamental pre-conditions for the roll-out of a transformative process of social investment relating to both the *fiscal viability* of one or a set of integrated jurisdictions and the operation of an effective system (effective systems) of *fiscal governance*.

- Fiscal viability denotes the ability over the medium- to long-term to generate sufficient fiscal resources - from taxation, social levies, service charges and other public revenues, as well as bond-issuance - to cover expenditure on capital goods and on associated recurrent costs. Social investment is an element of structural policy affecting the 'capital stock' of both the human participants and the institutional infrastructures of a political economy's social foundations, in contrast to public expenditure involved in managing the business and trade cycles.
- Fiscal governance denotes the framework of regulation, monitoring and policing of the revenue and expenditure flows affecting social investment; the primary objectives of effective fiscal governance are to ensure the transparent compliance of political, economic and social actors/agencies in the conduct of fiscal affairs and thereby to guarantee both the equity and the democratic answerability of all related transactions.

The point of departure of both dimensions of the model of social investment delineated here is set in deliberate contrast to the established and narrowly defined concepts of 'fiscal sustainability' and 'sustainable fiscal governance', which hitherto have been dominated by the neo-liberal/monetarist prioritisation of budgetary consolidation through deficit- and debt-reduction and the severe limitation of the public sector as an active manager of economic affairs (IMF 2015; European Commission 2016). Mainstream approaches to 'sustainability' have not simply failed to achieve their objectives of crowding-in private investment and secular growth through budgetary austerity, but have presided over a permissive approach to monopolisation (through mergers and acquisitions, cartels and trade 'wars') and to rent-extraction by investment-lazy businesses (Stockhammer, 2007).[22]

The precondition of fiscal capacity has, more recently, been acknowledged by the IMF in its discourse on fiscal 'space' (Coady, 2018, etc.) and in its empirical observations that economic development requires a minimum tax ratio (tax revenues as a proportion of GDP) of 15% (ibid.). WP7 reports have confirmed the evidence that levels of economic growth and economic welfare are NOT 'suffocated' by higher tax ratios, but rather boosted by the active deployment by the public sector of fiscal transfers. This evidence would seem to support the propositions of *Wagner's Law*, which postulated that higher levels of economic and political sophistication (refined division of labour and democratic answerability) would *ceteris paribus* involve increasing state ratios of revenue and expenditure. On the basis of the analyses of sectoral policies in the context of the RE-InVEST research, we would indeed identify the distributional implications of value-creation, working patterns, demography and environmental sustainability as powerful additional determinants of an expanding role of the public sector in the management of political economies in the foreseeable future. (The neglect of such conclusions runs the risk of exacerbating the current asymmetries and injustices in the distribution of income, wealth and access to the key resources of shelter, education, work, health, water).

22 Stockhammer notes OECD calculations showing? that the European average ratio of company profits that were reinvested fell from 47% in the 1970s to just 40% in the 2000s; Stockhammer, 2007: 119).

The chronic disparities in both the national tax ratios within the EU and the associated disparities of individual tax rates and tax regimes have been extensively covered in Part 1 of this report, and are corroborated by a growing body of literature on taxation affairs. From this follows the need for an extensive harmonisation and standardisation of both tax ratios, tax rates and tax allowances and of the associated accounting procedures. In particular, the 'erosion of progressivity' in income taxation within the 28 members of the EU has both compounded the disparities and generated a continuing process of destructive tax competition, notably in the taxation of capital (Leaman, 2014, Gentschel, 2011, Piketty, 2014). At the same time the inequities of separate tax regimes for incorporated enterprises (Corporation Tax) and non-incorporated enterprises (Assessed Personal Income Tax) have generated perverse incentives to minimise tax liabilities via complex schemes of tax avoidance, large-scale profit-shifting - from a high tax to a low-tax jurisdiction - and criminal tax evasion. (Shaxson, 2011 et al.).

Progressivity in income taxation is a vital precondition for tax regimes and expenditure programmes (like social investment) that seek to reduce disparities in market-driven income distribution. As noted before, the flat tax regimes introduced in central and east European EU Member States have to be abolished and replaced by arrangements which impose higher rates of taxation on higher levels of income. Furthermore, given the scale of income and wealth inequality that has been tolerated by permissive neo-liberal politics, there are increasing and persuasive calls for a restoration of the steeper curves of progression which used to capture the inordinately higher earnings of the top percentile/top 0.1% of high earners (refs). Such moves, which would be accompanied by efforts to reduce the unprecedented and wide wage and salary differentials that have emerged in recent decades, would enhance the tax capacity of countries embarking on ambitious programmes of social investment.

Reducing the disparities in both market incomes and post-transfer incomes would act already as positive multipliers in the traditional circuitry of demand, given the higher propensity of poorer households to channel their disposable income into consumption. Raising the revenue potential of the central, regional and local state would enable public agencies to set in motion the specific multiplier effects which social investment seeks to generate. It is vital in this context to stress the need to both acknowledge and to remove the *negative multiplier* effects that are observable in the decades characterised by neoliberal economic preferences. Reductions in the general rate of reinvested national income (investment ratio) and the resulting decline in national assets as a proportion of GDP can be correlated and generalised into a trend which has weakened the longer-term development potential of Europe as a region. One could apply all manner of metaphors to such trends to denote the relative weakening of socio-economic potential: soil erosion through the extraction of nutrients, neglect of house-repairs in the short-term at an increased long-term cost (recalling the semantics of economics as 'management of the house'). The most appropriate metaphor for negative multipliers might in fact be the concept of 'stunting' as applied to the United Nations Development Programme and similar deliberations on human development by the World Bank (UN, 2018; Galasso & Wagstaff, 2017; World Bank Group, 2016b; 2018).

It is in no way far-fetched to postulate a *'stunting effect'* on the development of human capabilities, on human capital, on social capital and on political economies which derives from the absence or the removal of factors that are essential for such development. Beyond the demonstrated correlation between growth deficiencies in small children and their later quality of life, notably in developing countries, the physiological consequences of unequal access to income, education, housing and health care have also been demonstrated in data relating to life expectancy in Europe (Bohácek et al., 2018): significantly increased life-chances and longevity for groups at the higher end of the income distribution; the data permit generalised conclusions about welfare regimes and the necessary macro-economic and macro-political conditions for social investment. Accordingly, cuts to welfare services, particularly those targeting early-stage promotion of health and education can be deemed negative multipliers with corresponding and accumulating negative ripple-effects through the circulatory system of the local, regional, national and supra-national political economy. Cuts to welfare services through fiscal austerity are thus socially and economically 'stunting' in their effects.

The corollary to the identification of negative multipliers is the design of an appropriate set of positive multipliers in well-crafted programmes of social investment. The 'ripple-effects' of such fiscal investment multipliers would, of necessity, be transformative over a far longer time-span than the archetypal, anti-recessionary fiscal stimuli of Keynesian provenance; several commentators speak of the need for 'patient capital' (Mazzucato, 2018: 171-4, Myles, 2017: 349ff). This is in contrast to the desired, and often frustrated need for rapid multiplier effects in cyclical crises, but it is also deliberately counterposed to the more recent short-termism of financialised capitalism, where patient capital has been in 'retreat' (Mazzucato, 2018: 171). In addition, the patience required of public capital invested in innovative processes of social experimentation involves a strong element of toleration towards the inherent risks and uncertainties of social, economic and political relationships.

It is unrealistic to assume that social investment programmes will be characterised by immediate, full-blown implementation of a whole set of initiatives, but rather by an initially piecemeal and experimental approach (Sabel et al., 2017: 143). This applies to decentralised, bottom-up initiatives, such as the RE-InVEST proposals envisage. Where neither the potential medium- and long-term effects of such initiatives are guaranteed a specific degree of measurable success, nor where new and unforeseen risks cannot be eliminated, the toleration of delays and possibly higher costs must be built into the macro-economic calculations, but the possibility that the multiplier 'returns' of fiscal social investment-stimuli exceed expectations cannot be ruled out. This reflects the general nature of public involvement in technological and commercial innovations, so often hidden from view but revealed in recent studies (Mazzucato, 2018; Murphy, 2011).

Mazzucato underscores not just the patience-dimension of publicly-funded investments in basic science and innovation, but above all the skewed relations in the 'risk-reward nexus' where public involvement has consistently meant a 'socialisation of risks and privatisation of rewards' (Mazzucato, 2015: 195ff). The neoliberal narrative of innovation and investment eschews any active role for the state in 'picking winners', stresses the failures but drastically underplays the positive function of publicly funded infrastructures, in particular the extensive financial support given to basic and applied research at universities and related institutions. That is, the public sector often shoulders the primary burden of R&D, from which private corporations are able to choose the most promising innovations, patenting them and securing the reward of medium-term income flows. Setting aside the further distortions of these processes through mergers and rent-extraction,[23] the core conclusion of this analysis of risk and reward in investment is the contrast between the micro-economic choices of enterprises in pursuing a commercial venture and the *inescapable responsibility and answerability* of public authorities for promoting the welfare of the population. Companies can limit the effects of externalities, and/or can withdraw from trading through asset-sales, insolvency or asset-shifting to other locations; democratic jurisdictions are obliged to meet the challenges of externalities, their citizens accordingly expect states to be dutiful and 'patient'.

The cost of long-term commitments to the comprehensive provision of public assets and services must, in conclusion, be set against the medium- and long-term growth in the national stock of human capabilities (capacities), of social capital and the maintenance/enhancement of the stock of natural capital (water resources, soils, air quality, bio-diversity, minerals). In this regard, social investment must be seen as value-creation, thereby reversing the general trend noted above of financial 'profits without accumulation', of value-extraction. This, of course, would also imply significant modifications to the way in which economic activity and its costs are measured and incorporated into national accounting systems. (References to De-Growth, Green New Deal debate)

23 Both Mazzucato (2013; 2018) and Foroohar (2016) give countless examples of the way public sector risk-taking allows inordinate profits for subsequent patent-holders/patent-acquirers and the scant reward flowing back to the state from funding breakthrough science in pharmaceuticals, solid-state physics or nano-technology. Above all they underscore the neglect of this skewed risk-reward nexus in mainstream economics and the myths of market-radicalism.

10. Fiscal subsidiarity and fiscal viability

A survey of the 2018 Country Reports from the so-called European Semester and other sources of evidence indicates that the developmental logic of social investment is already taking root in the EU's 28 Member States; the focus of expenditure plans on early-stage childcare and education, on research and innovation and on health in a number of states reflects a partial effort to redress longer-term structural weaknesses in the economic and social cultures in the period of very slow recovery after the 2008 Crash. However, what the ESCR surveys also reveal is both the patchiness of social investment-initiatives and the continuing subordination of national programmes to the dominant commitments not just to fiscal consolidation but to balanced budgets in the short- to medium-term and legally binding 'brakes' on deficits and debt. Such commitments are overseen by Fiscal Councils (Estonia, Hungary, Ireland, Romania), a Fiscal Discipline Council (Latvia), Stability Council (Germany), Public Finance Council (Portugal), High Council of Finance (Belgium) and Fiscal Advisory Council (Austria), etc.[24].

The legal and political constraints on member state expenditure and debt represent formal structural obstacles to transformative social investment, even before the specific and critical needs of less-developed Member States are considered. As earlier reports noted, the Commission has suggested that the Regional/ Cohesion Fund grants to Member States could and should be deployed to fund social investment initiatives. However, the volume of the EU's regional funding is insufficient to achieve the scale of convergence in national levels of productivity or economic modernisation that would allow the Union to 'cohere' more effectively and prevent the current trends towards fragmentation. The scope of regional funding will also suffer further constraints if and when the UK's budgetary contributions are reduced or curtailed. The political limitations on EU-budgets are well known and a source of frustration to those who see the merits in principle and the long-term real advantages of more generous fiscal equalisation within the EU28/Eurozone, but the direction of travel signalled in the 2013-2020 Multiannual Financial Framework - with lower contribution-to-GDP ratios - reinforces the gap between cohesion ambitions and cohesion feasibility (c.f. EuroMemo recommendations for an average 5% contribution ratio). This contradiction between ambition and feasibility applies to social investment programmes in a number of ways that go beyond the simple limits set by the MFF:

- Most of the countries with the largest deficiencies in the provision of educational, health and social services also have significant deficiencies in the area of fiscal viability: low state/tax ratios; flat tax regimes that are devoid of - or severely lacking in redistributive features and are excessively dependent on regressive mass taxes on consumption. The EU provides no guidance or incentives on the critical importance of tax ratios and tax rates, with the exception of the long-standing floor-rate of 15% for standard VAT.
- These fiscal weaknesses could be improved through transfers from richer Member States in the spirit of fiscal equalisation and convergence, but they are in large measure a symptom of tax competition between EU-Member States to attract inward flows of capital through much lower rates of capital taxation. This poaching of tax bases, either through full company relocations or simply through profit-shifting clearly reduces the preparedness of wealthier states to assist other Member States that deliberately weaken their revenue potential.

24 A full survey of Independent Fiscal Institutions can be found on the Commission's website: https://ec.europa.eu/info/business-economy-euro/indicators-statistics/economic-databases/fiscal-governance-eu-member-states/what-fiscal-governance_en

- The objectives of the EU's social policy programmes, including social investment, are not subject to punitive sanctions in the case of failure to deliver. This is in stark contrast to the severe sanctions imposed on Member States for non-compliance with the rules of the Stability and Growth Pact and its successors. Social (investment) expenditure remains discretionary; rules covering fiscal 'sustainability' are mandatory and severe, as demonstrated by the application of budgetary austerity to southern European Member States in Europe's worst economic depression in living memory after 2008.

To repeat our earlier conclusions: without a concerted effort on the part of the European Commission to establish a culture of *fiscal viability* which addresses the revenue element of fiscal governance as well as expenditure and debt, transformative pan-EU programmes of social investment will fail. Harmonisation of tax ratios, major tax rates and tax compliance regimes is essential to ensure the sustainability of the European Union as such. Under the current circumstances the scope of social investment initiatives will be extremely limited. States, particularly those with major problems of youth unemployment, human capital migration, high AROP figures and high levels of real material hardship, will be forced to prioritise according to perceived levels of urgency. In all cases, there should be clear efforts to separate routine, recurrent social policies aimed at maintaining living standards and health from longer-term, strategic capital expenditure aimed at enhancing human and social capital and maintaining /restoring natural capital.

In order to achieve a sustainable convergence of improved levels of human and social capital - within and between nations - the transmission of resources and ideas has to be both efficient and equitable. Within the framework of a bottom-up approach, rooted in the identifiable needs and preferences of community-based initiatives, the metaphor of a healthy blood-supply is appropriate. The viability of the political economy as a social organism is crucially dependent on a constant and well-balanced delivery of blood to the furthest capillaries. An insufficient flow threatens the viability not only of the extremities but of the whole organism. The complex interdependence of Europe's advanced political economies makes such organic metaphors valuable as heuristic vehicles for understanding. Furthermore, it is arguably vital that the new narrative of social investment - as public goods and sources of 'value' - is transmitted to the outermost reaches of the same organism, above all neutralising the neo-liberal narrative and its hostility to public/collective interventions which, according to authors like Crouch, became well embedded in popular consciousness.[25] Without this supportive narrative of what Murphy defines as the 'courageous state' (Murphy 2011), even the best resourced and best administered programme will remain vulnerable to the ideological opponents of solidaristic, international, inter-generational systems of social investment.

25 Crouch employs the 'capillaries' metaphor to express this embeddedness.

11. Decentralisation, fiscal autonomy and fiscal equalisation

The success of the transmission process is itself vitally dependent on the correct design of the institutional agencies of social investment and the capabilities of the teams of personnel operating within them. While the institutional design must be tailored to the size and constitutional structures of individual jurisdictions, there are examples of good and sub-optimal practice which could and should be considered by the architects of national and local transformative social investment programmes. In 2014, the OECD produced recommendations on *Effective Public Investment across Levels of Government*, which included the principles of coordination between central and sub-national levels of government and the need to develop a fiscal framework 'adapted to the investment objectives pursued' (OECD, 2014). Given that on average in Europe some 52% of all investment is conducted by sub-national authorities, the case for strong and stable revenue potential at sub-central level is unanswerable (Sauter, Illés & Nunez, 2014).[26] Blöchliger and Petzold rightly note the risk of fiscal autonomy in tax affairs creating wider disparities in per capita revenue and thus make a strong case for a 'well-functioning equalisation system':

> *'The empirical evidence tends to support the belief that more sub-central tax autonomy is associated with larger fiscal disparities, potentially requiring larger fiscal equalisation systems. For political economy reasons, any country wishing to increase sub-central tax autonomy is likely obliged to increase the share of transfers dedicated to fiscal equalisation. There is some consensus that fiscal equalisation is a necessary companion to tax decentralisation and that success of the second is likely to depend on a well-functioning equalisation system'* (Blöchliger & Petzold, 2009: 21).

Eurostat data indicate wide disparities in both the levels of fiscal responsibility enjoyed by sub-national levels of the state and between their respective shares of revenue and expenditure (See Table a.1.1 in Statistical Appendix). In all cases the responsibility of SNG for expenditure exceeds the proportion of tax and other revenue enjoyed by lower levels of the state; in certain instances this is explicable by the modest size of the 7 EU statelets with fewer than 3 million inhabitants (Cyprus, Estonia, Latvia, Lithuania, Luxembourg, Malta, Slovenia), but there are several states where the dependency of sub-national units on grants and discretionary transfers is not conducive to long-term, ambitious planning on the scale require by transformative social investment programmes. While some of these disparities are clearly linked to Blöchliger and Petzold's observation about positive discrimination in the form of fiscal equalisation for poorer SNGs (e.g. in Austria, Belgium, Denmark, Finland, Sweden), others reflect issues surrounding weaker absorption capacities and corruption in newer Member States (Bulgaria, Romania) and the tightening of central controls on local spending and borrowing (Greece, UK).[27]

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26 The centrality of tax revenue is again underlined by Blöchliger and King (2005: 3): 'the statistics show that taxes are still the most significant revenue source for subcentral governments but that only a part is under their effective control. Fiscal autonomy is further reduced by a high percentage of earmarked grants'.

27 The marked reduction of local government revenue in the UK reflects the (mis-)use of the central government's discretionary powers and austerity preferences, while Greece's drastic rationalisation of local government structures and fiscal cutbacks is attributable largely to Troika austerity impositions.

Table 11.1 Primary fiscal distribution in European federal states

	Sub-national share of revenue	Sub-national share of expenditure
	2016	2016
Austria	10	31.5
Belgium	23.6	44.9
Germany	36.8	40.1
Spain	27.9	44.4

Source Eurostat; C.f. Table a1.1 in Statistical Appendix below

Federal systems are often held up as examples of best practice in fiscal distribution and fiscal governance, particularly if they have refined arrangements for fiscal equalisation. In the Federal Republic of Germany, the close match of revenue and expenditure shares (Table 11.1 above) would seem to confirm the virtues of a well-managed system of subsidiarity, in particular if set against the background of the challenge of absorbing the five new *Länder* into these fiscal arrangements after 1990. Through a long-standing system of 'cooperative federalism' legally fixed proportions of major tax revenues are allocated to German SNGs, underpinned by refined arrangements of vertical and horizontal fiscal equalisation,[28] there have been regular political moves by richer regions to limit horizontal transfers to poorer regions, but these have not prevented the core advantages of fiscal federalism remaining embedded in German political and economic culture: namely securing social peace through the promotion of regional clusters of industrial, scientific and commercial activity which contrast favourably with the concentrated agglomerations of economic and political power in unitary systems. It should be noted, however, that current practice in Europe's largest federal political system is severely constrained by the 2009 constitutional commitment to deficit - and debt - reduction (*Schuldenbremse*) which limits the central state to a maximum borrowing level of 0.35% of GDP in normal economic conditions and obliges both regional states and local authorities to zero borrowing requirements in their annual budgets from 2020 onwards. The Article 106 of the German constitution permits a deviation from these strict rules only in case of natural catastrophes and severe recessions (Article 106, Paragraph 3.1, 3.2, 3.3).

More ominously for this (potential) model of best practice in fiscal governance, the commitment to balanced budgets in the medium term has been incorporated into legal statute in several EU states, including Spain, and remains a core ambition of EU fiscal governance. As noted in previous reports, this defies the empirical evidence of the failure of monetarist practice, most famously demonstrated by the debunking of the Reinhardt and Rogoff threshold hypothesis, which asserted negative growth effects from state debt ratios exceeding 90%.[29]

Germany's long-term growth performance was one of the weakest in the EU from 1994 to 2009, with real GDP rising at an average annual rate of 1.1% (Euro Area: 1.76%; OECD: 2.3%); its Investment Ratio (as a proportion of GDP) sank in the same period from 24% down to 19.2%, where the decline in the public sector's investment ratio acted as a negative multiplier. As the data provided by an ECB study of public investment in Europe show, Germany indeed had the second worst record for public investment in Europe (ECB chart below). While not wishing to underplay the role of externalities in Germany's relatively poor performance, the evidence remains strong of a robust correlation between the austerity regime imposed by Germany's ordo-liberal policy preferences on the behaviour of its public sector and also between Germany's dominance of the EU's macro-economic policy preferences since Maastricht and the EMU-process.

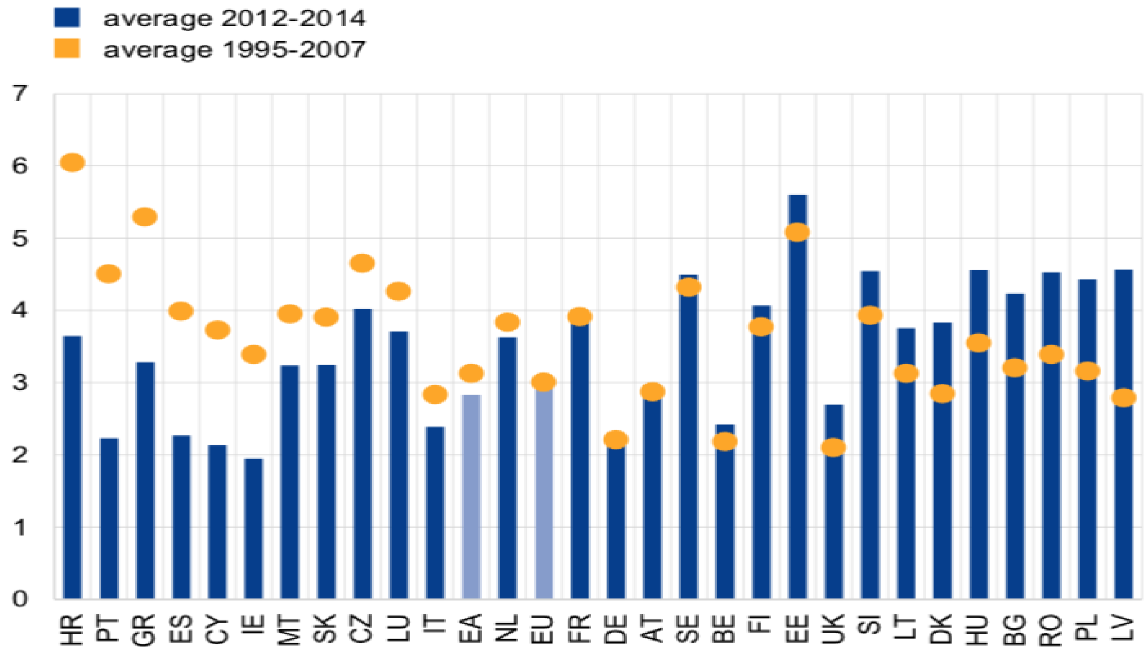
In the context of a search for best practice in fiscal governance, Germany remains a frustrating candidate, offering legal/constitutional arrangements close to an optimal scheme of subsidiarity in principle (and

28 Blöchliger & Petzold (2009) underscore this key issue: 'Tax sharing arrangements where central government cedes a part of its income or consumption tax revenue could help lift the SCG tax share without increasing the total tax burden'.

29 Researchers at the University of Massachusetts, Amherst, revealed basic data flaws in the Reinhardt/Rogoff calculations (Hernden, Ash and Pollin, 2013).

longer-term historical experience) and current dysfunctional handicapped practice, shackled to a discredited fetishisation of debt.

Figure 11.1 Public investment to GDP ratio as a percentage of GDP



* Countries ordered by change in average public investment 2012-14 versus 1995-2007.
Source European Commission

While this report concurs with many of the findings of the OECD in its recommendations on 'effective public investment across levels of government' (OECD, 2014; OECD/UCLG, 2016; OECD/CoR, 2016) and its promotion of the case for devolved planning and local stakeholder involvement within an integrated framework of coordination, it is again necessary to draw attention to the scant regard given to the serious anomalies of revenue-generation and revenue distribution in European systems of fiscal governance (see box below). All of the recommendations, apart from nr. 6, apply equally well to the processes of social investment; for several reasons, including the extended time-horizons of social investment but also the principled objection to the use of social investment as a vehicle for comfortable rent-seeking, the OECD focus on private funding sources is inappropriate. The OECD's valuable work on sub-national public actors does allow a number of important conclusions, which are *not* drawn in its own recommendations: the willingness of local politicians and administrators to embark on long-term investments in social infrastructure and human capital development is not enhanced by the structural funding-gaps, evident in revenue and expenditure data, particularly when they are reinforced by serial requests to make 'efficiency savings', i.e. by the austerity imperatives of central authorities; the unpredictability of future flows of funding, particularly when central authorities choose to extend their powers of discretion, will strengthen downside calculations in impact- and risk-assessments (Rec. 4), notably in achieving the 'relevant scale' of investments (Rec. 3).

OECD Recommendations on Effective Public Investment: Co-ordination, Policy-Learning; Proper Framework Conditions

1. Invest using an integrated strategy tailored to different places;
2. Adopt effective instruments for co-ordinating across national and sub-national levels of government;
3. Co-ordinate horizontally among sub-national governments to invest at the relevant scale;
4. Assess upfront the long-term impacts and risks of public investment;
5. Engage with stakeholders throughout the investment cycle;
6. Mobilise private actors and financing institutions to diversify sources of funding and strengthen capacities;
7. Reinforce the expertise of public officials and institutions involved in public investment;
8. Focus on results and promote learning from experience;
9. Develop a fiscal framework adapted to the investment objective pursued;
10. Require sound and transparent financial management at all levels of government;
11. Promote transparency and strategic use of public procurement at all levels of government;
12. trive for quality and consistency in regulatory systems across levels of government.

Source: OECD 2014: 25f

12. Concluding remarks

The OECD rightly recommends the development of 'a fiscal framework adapted to the investment object pursued' (2014: 26). This is eminently applicable to the societal challenge of medium- to long-term social investment. If the Commission's social investment-initiative has one distinguishing feature, it is its integrated, multi-dimensional, multi-layered, multi-national ambition. It goes beyond the traditional reactive, palliative kind of social policy to a pro-active developmental programme that sees an inescapable connection between macro-economic development, human capabilities and social cohesion. To this extent it is visionary. The RE-InVEST project takes the developmental ambition a step further by placing the cohesive role of human capabilities, human rights and environmental sustainability at the centre of an integrated and transformative variant of social investment. It thus resembles what Mariana Mazzucato defines as a 'mission-oriented' investment (2018: 226; 278). While the Commission-variant arguably remains anchored in a mainstream narrative dominated by quantitative growth and capital accumulation, the RE-InVEST focus on human capabilities, social and natural capital represents a radical departure from the mainstream, questioning rent-seeking and the primacy of exchange values, and suggesting new priorities of human welfare and environmental sustainability.[30]

This long-term mission-oriented approach can only succeed with the active participation of state and social actors at all levels. The public sector is, in this instance, the risk-taker and the investment-funder of first resort. The scale and the time-horizons of social investment involve risks which private investment funds are very unlikely to either support or sustain. The cumulative, multiplier effects of the social investment-developmental process will be subject to time-lags and the interference of cyclical and other shocks, such that only the 'patient capital' of a democratically legitimated state can provide.

The fiscal framework and its governance are absolutely central to the success of innovative social investment. It has to be generous and visionary in its orientation. It must also seek to be an example of best practice for less developed and emerging political economies. Above all, it must seek to reverse the erosion of fiscal viability that has afflicted European states in recent decades, firstly in the tax- and location-competition between the advanced economies of the OECD, secondly and particularly in the destructive beggar-thy-neighbour policies of many post-communist Member States. The additional and arbitrary rules of monetarist restrictions on fiscal policy have rendered more and more states in Europe vulnerable to both short-term cyclical shocks, and to the structural challenges of economic, social, demographic and environmental crises. The toleration of critical elements of inequality within and between Member States has made the scale of such challenges even more daunting. The deployment of increasing volumes of fiscal resources to fund the recurrent fire-fighting expenditure, compensating for widening disparities of market income, for real material deprivation, for youth unemployment and housing costs as symptoms of social crisis, underscores the critical role of the state in democratic societies, but also weakens the ability of the same state to address the structural causes of those symptoms. It ironically confirms the validity of Wagner's Law - of a growing call on collective/state resources to sustain the increasingly complex relationships of modern political economies - despite the objections of ordo-liberals but at the expense of a more enlightened application of long-term strategic planning for future complexities, future challenges. Thus capital expenditure

30 In her recent book The Value of Everything, Marianna Mazzucato encapsulates the intellectual challenge of investing for the future: 'The concept of value must once again find its rightful place at the centre of economic thinking. More fulfilling jobs, less pollution, better care, more equal pay – what sort of economy do we want? When that question is answered we can decide how to shape our economic activities, thereby moving activities that fulfil these goals inside the production boundary so they are rewarded for steering growth in the ways we deem desirable. And in the meantime we can also make a much better job of reducing activities that are purely about rent-seeking and calibrating rewards more closely with truly productive activity' (Mazzucato 2018: 279).

in short- and longer-term public investments has recently been the victim of budgetary consolidation, as noted with some alarm by the OECD:

> *'Since 2010, consolidation strategies have reduced the resources for public investment, putting public investment onto a downward path, even as private investment in many countries has continued to contract. Being one of the most flexible items in the budget, public investment has been used as an adjustment variable. While investments peaked in 2009 with the stimulus packages, the annual level across the OECD has not yet recovered to pre-crisis levels. Compared to 2007, public investment per capita in 2012 had fallen in 15 out of 33 OECD countries. While not all OECD countries followed this trend, a sustained contraction in public investment at a time of sluggish growth may have negative long-term consequences for national growth and societal well-being.'* (OECD 2014: 5).

The essential objectives of the RE-InVEST conception of social investment are to avoid such negative consequences and to enhance societal well-being. This requires above all structural reforms of macro-economic culture with an accompanying new and positive narrative of the role of the state and social stakeholders, in particular in relation to fiscal affairs. Such 'structural reforms' will be explicitly distinct from the frequent iterations of supply-side mantras of deregulation, privatisation and 'crowding-in' private investment. Rather, the structural reforms will be to the foundations of fiscal viability, creating a fiscal framework which is appropriate 'to the investment objective pursued' (OECD, 2014). In simple terms this means equipping the state at all levels with the resources to do its job. An under-resourced, reactive, defensive and unimaginative state cannot be expected to 'do its job' and is more likely to remain captured by sectional and economically dysfunctional interests.

The focus on *fiscal viability* demands in turn a radical modification of the EU's concept of fiscal sustainability qua *fiscal rules* (Leaman, 2016). If society cannot, above all, afford to preside over economic and social dis-integration, then it must devise effective fiscal and governance mechanisms to realise its policy goals, above all those of *convergence* and *cohesion*.[31]

1. The 28 states of the EU region must set appropriate allocatory priorities on the basis of shared commitments, common fiscal standards and equity. This indispensable foundation of cross-national, EU-wide social investment is still barely discernible in 2019. In particular, critical elements of fiscal viability and multilateral fiscal responsibility are absent. The wide disparity between the tax ratios of the fiscally weak EU states (Baltic and Balkan groups) and the major economies of the old EU15 (Austria, Belgium, Denmark, Finland, France, Germany, Netherlands, Sweden, UK) needs to be narrowed; indeed the flattening of the curves of progression in those EU states with progressive systems of income taxation has to be reversed and the fiscal resources of the weaker states have to be boosted by appropriate changes to their tax systems and tax cultures. Failure to achieve this leaves *all* Member States vulnerable to tax arbitrage pressure from mobile corporations.
2. Consequently, the CEECs with systems of flat taxes (single-rate proportional levies on taxable income) have to be encouraged/incentivised to (re)introduce progressive systems of income tax with curves of progression similar (if not identical) to those obtaining in the old EU15; a harmonisation of tax systems, involving a convergence of marginal rates at both the lower and higher ends of the income scale and a closer alignment of tax allowances for both households and businesses would be an important first step in a - for certain CEECs - radical transformation of the state's ability to raise revenues and deploy those revenues effectively; because of the GDP per capita divergences, EU Member States - via ECO-FIN - would have to agree to both *slightly lower levels of capital and income taxation to ease the transition to a state of fiscal viability* (c.f. Leaman, 2016); this specific process of promoting the modernisation of fiscally weaker Member States should be accompanied by a closer harmonisation of tax cultures across the whole Union, firstly to prevent destructive tax competition between Member States ('divide and conquer' tax arbitrage tactics by TNCs) and to reduce the contradictions between top marginal rates for

31 The following recommendations are an expanded set included in an earlier report on the Macro-Economic challenges of Social Investment (Leaman, 2018).

Personal Income Tax and the (currently much lower) standard or top rates for Corporation Tax; this in turn would remove the incentive for SMEs to 'incorporate' (c.f. Leaman, 2012: 164f).

3. The strengthening of progressivity would, of itself, increase the revenue share of direct taxes; however, Member States should be encouraged to reduce the regressive effect of a still excessive dependence of indirect taxation, for example through a stronger differentiation of taxable goods and services, favouring basic commodities and services with socially and environmentally progressive functions (children's clothing, housing, education, health, renewable energy, decontamination, bio-diversity).
4. Narrowing the divergence of tax and revenue cultures would, in the medium term, still leave weaker jurisdictions less well placed to promote both overall development and, above all, social investment. There is consequently a very strong case for strengthening/deepening the fiscal arrangements of both the Eurozone and the wider EU to increase markedly the resources available through the structural/cohesion funds. The allocation of enhanced funding for poorer states/regions, for example, could reasonably be conditional on the implementation of progressive social investment programmes; these in turn could be subject to compliance procedures with at least as much leverage/compulsion as the rules governing state deficit and debt ceilings.
5. There is an urgent need to promote a strong and sustainable convergence of levels of fiscal viability both via arrangements of vertical and horizontal fiscal equalisation (money transfers to weaker regions/political economies) within the EU28 and via collective liability for both short-term public deficits and long-term state debts, qua Eurobonds. Again, the issuance of Eurobonds could be made conditional on the targeted use of funds for the provision of vital public goods, including economic and social infrastructure and social investment.
6. Harmonisation and cooperation in tax affairs is most obviously needed in the field of tax avoidance and tax evasion. The scale of revenue loss is eye-wateringly high. Herman Van Rompuy, the former president of the EU Commission spoke of a figure of €1 Trillion annually to EU treasuries (Reuters, 12.4.2013; c.f. also Tax Justice Network, 2011). Recovering revenue of this magnitude would certainly present difficulties, given the globally permissive environment for tax-evasion, profit-shifting and tax-avoidance. However, the prize of European cooperation in closing loopholes and stopping intra-European profit-shifting (through the rigorous application of the OECD's BEPS guidelines) would be considerable given that Van Rompuy's €1 trillion is six times the 2018 EU budget. Progress on combatting tax avoidance/evasion at both EU and national level has been disappointingly slow, despite the overwhelming evidence of public opinion polls, strong civil society initiatives and cross-party proposals in the European Parliament; there is therefore a real danger that the failure to rectify the perceived injustice of tax-cheating and the associated wide disparities in the distribution of income and wealth will fuel the growing populist resentment against established political 'elites'.
7. Given the high level of mobility for financial capital and the improbability of the imposition of effective exchange controls within the global political economy, the case for an annual wealth tax has become more popular and more promising. Thomas Piketty (2014: 528) makes a persuasive case for a progressive wealth tax: *'Take, for example, a wealth tax of 0% on fortunes below €1 million, 1% between 1 and €5 million, and 2% above €5 million. If applied to all Member States of the European Union, such a tax would affect about 2.5% of the population and bring in revenues equivalent to 2% of Europe's GDP'.* The essential feature of such a tax would be unanimity and harmonised standards among EU Member States and the automatic sharing of bank information within the EU and with third countries.[32]
8. The more recent initiatives to tax the global 'big tech' corporations (Hill, Khan & Waters 2018) need to be pursued with greater urgency. Notwithstanding the difficulty for tax authorities to identify the location of big tech profits, revenues and associated abuse, tolerating the emergence of untouchable, untaxable financial assets is highly corrosive of democratic cultures and the principles of tax justice. '*Isolated,*

32 A report commissioned by the Greens/EFA group in the European Parliament (Knobel, 2018: 22) notes that Austria, Bulgaria, Cyprus and Romania have limited their preparedness to exchange banking information.

national initiatives are arguably doomed. Bold, multilateral approaches are essential, if EU states wish to avoid being victims of tax and regulatory arbitrage.' (Brundsden 2018).

The social investment envisaged by the RE-InVEST project unequivocally *creates value* for current and future generations. Conceived as a multinational programme, it has the potential to influence human development not just in Europe but, significantly also, in the emerging democracies and political economies of the world. Increasing the value of the stock of human capabilities and social capital, and protecting the value of natural capital is simply a pre-condition for the survival of decent, democratic civilisation. Above all, the dangerous narrative that social expenditure is a cost to be borne as a burden on taxpayers needs to be refuted. From a macro-economic perspective, the wide range of social policy fields is inescapably bound into the circuitry of production, service-provision, consumption, distribution and investment. Limiting its resources as a temporary cure for temporary, cyclical revenue shortfalls is more likely to stunt economic development counter-productively, than crowd-in private solutions to economic challenges. Well-managed programmes of social investment can have astonishing, positive multiplier effects within national and international political economies. Above all, social investment as a mission-oriented, long-term collective programme involving public authorities and citizens can play a critical role in eliminating the worst features of parasitic rent-extraction tolerated by a permissive and negligent politics of neoliberalism.

appendix 1 Statistical annex

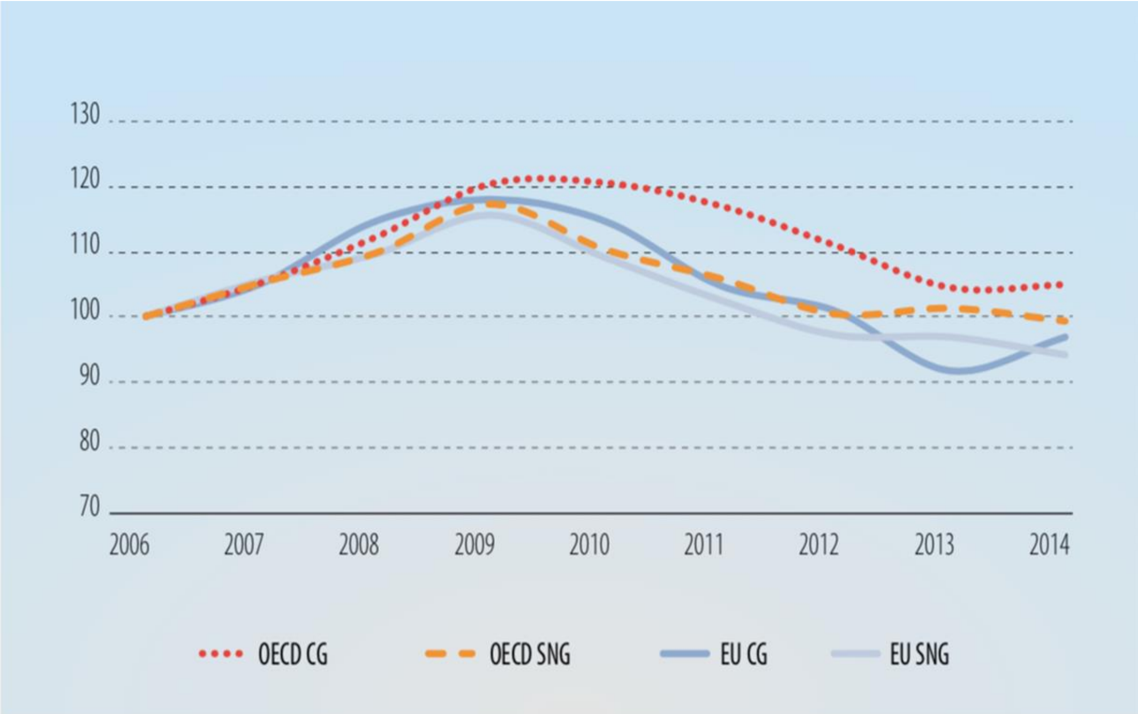
Table a1.1 Macro-economic imbalances in the EU28

	GDP pc 2017	Inv Ratio 2017	Wage Sh	Tax Ratio 2016	CA +/-2018	YUR Dec 2018	Material Depr 2018	AROP 2018	Gini Various	PSBRQ 3 2018	State debt 3/18
Austria	110.5	23.5	48.1	42.3	1.92	8.9	3.7	18.1	30.5	-0.2	75.6
Belgium	110.7	23.3	50.3	44.4	0.72	15.4	5.1	20.3	28.1	0.4	105.4
Bulgaria	49.4	18.5	41.3	29.0	6.65	12.8	30.0	38.9	37.4	3.6	23.1
Croatia	64.0	20.0	47.4	37.8	5.43	22.7	10.3	26.4	32.2	n.a	74.5
Cyprus	89.5	20.9	44.3	33.6	-8.4	18.67	11.5	25.2	35.6	n.a.	110.0
Czech Rep	67.4	25.2	39.9	34.7	0.89	5.8	3.7	12.2	25.9	0.7	33.9
Denmark	132.3	20.4	51.7	46.4	8.09	8.7	3.1	17.2	28.5	-0.4	35.2
Estonia	75.9	23.7	48	34.5	3.32	12.2	3.8	23.4	34.6	0.3	8.0
Finland	124.2	22.6	49	44.1	-0.62	17.2	2.1	15.7	26.8	-0.9	58.5
France	109.8	22.5	52.1	45.6	-0.52	21.1	4.1	17.1	32.3	-3.1	99.5
Germany	106.8	20.3	50.7	39.0	7.93	6	3.4	19	31.4	1.6	61
Greece	83.0	12.7	32.5	38.8	-0.87	38.5	21.1	34.8	35.8	n.a.	182.2
Hungary	62.3	21.5	41.3	39.3	3.17	10.2	10.5	25.6	30.9	-1.1	72.4
Ireland	112.8	23.4	30.6	23.3	8.72	12.2	5.2	22.7	31.9	n.a.	68.8
Italy	98.6	17.5	39.6	42.6	2.87	31.9	10.1	28.9	34.7	n.a.	133
Latvia	69.5	19.9	44.5	31.2	-0.81	10.8	9.5	28.2	35.1	-2.1	37.1
Lithuania	63.5	18.8	41.7	29.8	0.98	10.5	12.4	29.6	37.7	0.6	35
Luxembourg	122.0	17.1	48.2	38.3	4.74	11.9	1.2	21.5	31.2	3.1	21.7
Malta	82.4	21.4	43.9	32.7	13.8	12.3	3.3	19.2	29.4	3.8	45.9
Netherlands	112.0	20.3	49	38.8	10.6	6.6	2.6	17	28.6	2.2	52.9
Poland	58.2	17.7	36.9	33.4	0.11	10.5	5.9	19.5	32.1	-0.8	49.4
Portugal	82.2	16.1	43.6	34.4	0.54	17.6	6.0	23.3	35.6	3.6	125
Romania	51.0	22.6	32.3	25.9	-3.2	16.2	19.7	35.7	27.5	-3.6	33.9
Slovakia	68.3	21.2	38.4	32.2	-2.0	13.8	7.0	16.3	26.1	-1.5	51.5
Slovenia	81.5	18.5	49	36.6	7.1	9.7	3.7	17.1	25.7	0.4	71.0
Spain	90.8	20.5	47.4	33.3	1.91	32.7	5.1	26.6	36.2	n.a.	98.3
Sweden	130.2	24.9	47.4	44.1	3.3	16.6	1.1	17.7	27.2	0.6	38.3
UK	111.6	16.9	49.7	33.7	-3.75	11.5	4.1	22.0	34.1	-1.1	86.3

* GDP pc: Gross Domestic Product per capita adjusted for purchasing power parity; IR: Gross fixed capital formation as percent of GDP; TR: Ratio of tax revenue, including social contributions, to GDP; CA: Current Account Balance as % of GDP; YUR: Youth Unemployment Rate; Material Depr: Proportion of population suffering severe material hardship; AROP: pro-portion of population at risk of poverty (below 60% of median income); PSBR: annual public sector borrowing requirement/state budget deficit; State debt: total public sector liabilities; GC: Gini Coefficient of Income Inequality; Wage Share: Share of wages and salaries in national income before taxes and transfers.

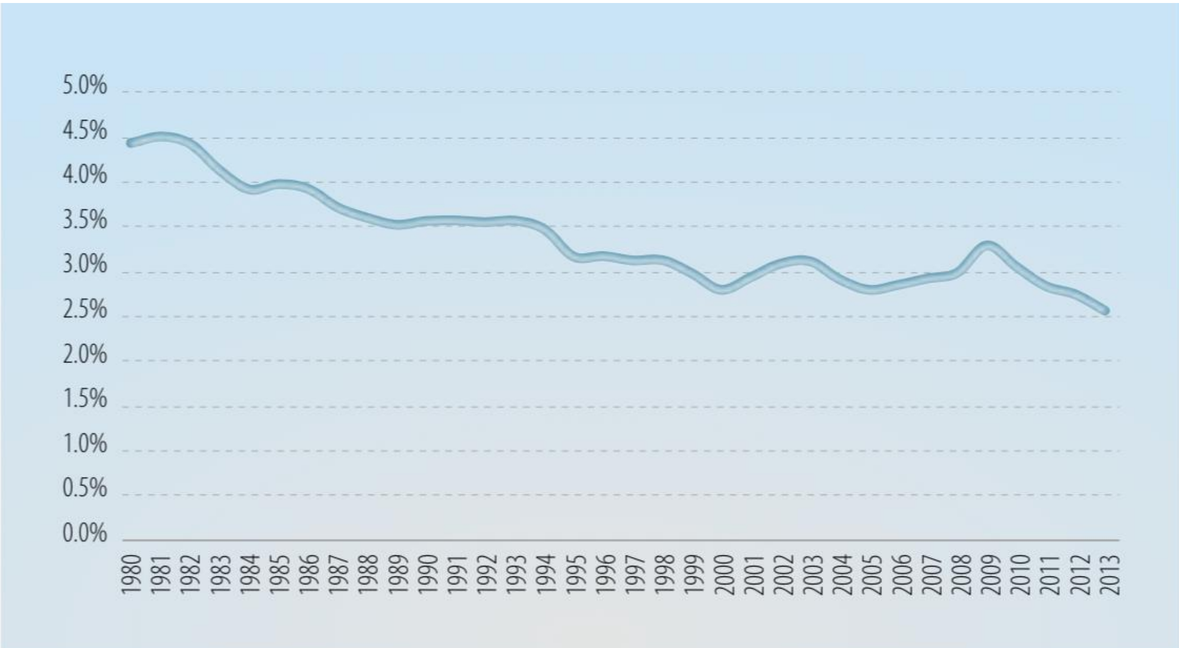
Source Eurostat; World Bank

Figure a1.1 Public investment at the sub-national in the EU (2005-2014) (Base 100 = 2005)



Source OECD National Accounts and Eurostat

Figure a1.2 Public investment as a share of GDP in OECD countries (1980-2013)



Source OECD (2016)

Table a1.2 State form and sub-national government structures in the EU28 (2015)

	State form*	Pop mill.	Total SNG units	Municipal level	Intermediate	Regional	Average municipal size
Austria	Fed	8.5	2,109	2,100	0	9	4,090
Belgium	Fed	11.2	605	589	10	6	19,030
Bulgaria	Unit	7.2	265	265	0	0	27,160
Croatia	Unit	4.2	576	555	0	21	7,625
Cyprus		1.2	526/380	526/380	0	0	2,190/2,125
Czech Rep	Unit	10.5	6,272	6,258	0	14	1,640
Denmark	Unit	5.6	103	98	0	5	58,155
Estonia	Unit	1.3	213	213	0	0	6,165
Finland	Unit	5.5	314	313	0	1	17,530
France	Unit	66.2	36,004	35,885	101	18	1,855
Germany	Fed	81	11,510	11,092	402	16	7,320
Greece	Unit	10.9	338	325	0	13	33,410
Hungary	Unit	9.9	3,197	3,178	0	19	3,125
Ireland	Unit	4.6	31	31	0	0	4,445
Italy	Unit	60.8	8,174	8,047	107	20	7,545
Latvia	Unit	2	119	119	0	0	16,760
Lithuania	Unit	2.9	60	60	0	0	48,875
Luxembourg	Unit	0.6	105	105	0	0	5,360
Malta	Unit	0.4	68	68	0	0	6,285
Netherlands	Unit	16.9	402	390	0	12	43,540
Poland	Unit	38.5	2,874	2,478	380	16	15,530
Portugal	Unit	10.4	310	308	0	2	33,400
Romania	Unit	19.9	3,223	3,181	0	42	6,260
Slovakia	Unit	5.34	2,935	2,927	0	8	1,850
Slovenia	Unit	2.1	212	212	0	0	9,730
Spain	Qu-Fed	46.5	8,186	8,119	50	17	5,605
Sweden	Unit	9.7	311	290	0	21	33,890
UK	Unit	64.6	419	389	27	3	166,060

* Fed: Federal; Q-Fed: Quasi-Federal; unit: unitary/centralised.
Source OECD/ULCG (2016: 80-81)

Table a1.3 Disparities in sub-national shares of revenue and expenditure in the EU28 (2016)

	Sub-national share of revenue	Sub-national share of expenditure
	2016	2016
Austria	10	31.5
Belgium	23.6	44.9
Bulgaria	8.1	19.7
Croatia	13.9	24.3
Cyprus	2.2	3.8
Czech Rep	18.2	25.7
Denmark	28	63.6
Estonia	4.1	23
Finland	28.3	39.3
France	16	19.4
Germany	36.8	40.1
Greece	3	7
Hungary	7.2	12.7
Ireland	4.6	7.5
Italy	17.4	27.4
Latvia	18.2	25.4
Lithuania	3.1	22.9
Luxembourg	5.9	10.9
Malta	0.2	1
Netherlands	8.7	31.4
Poland	15.5	30.9
Portugal	10.4	12.4
Romania	6.6	26.6
Slovakia	5.1	15.8
Slovenia	12	18
Spain	27.9	44.4
Sweden	33.3	50.1
UK	8.6	23.9

Source Eurostat

Figure a1.3 **Nurturing human capital**

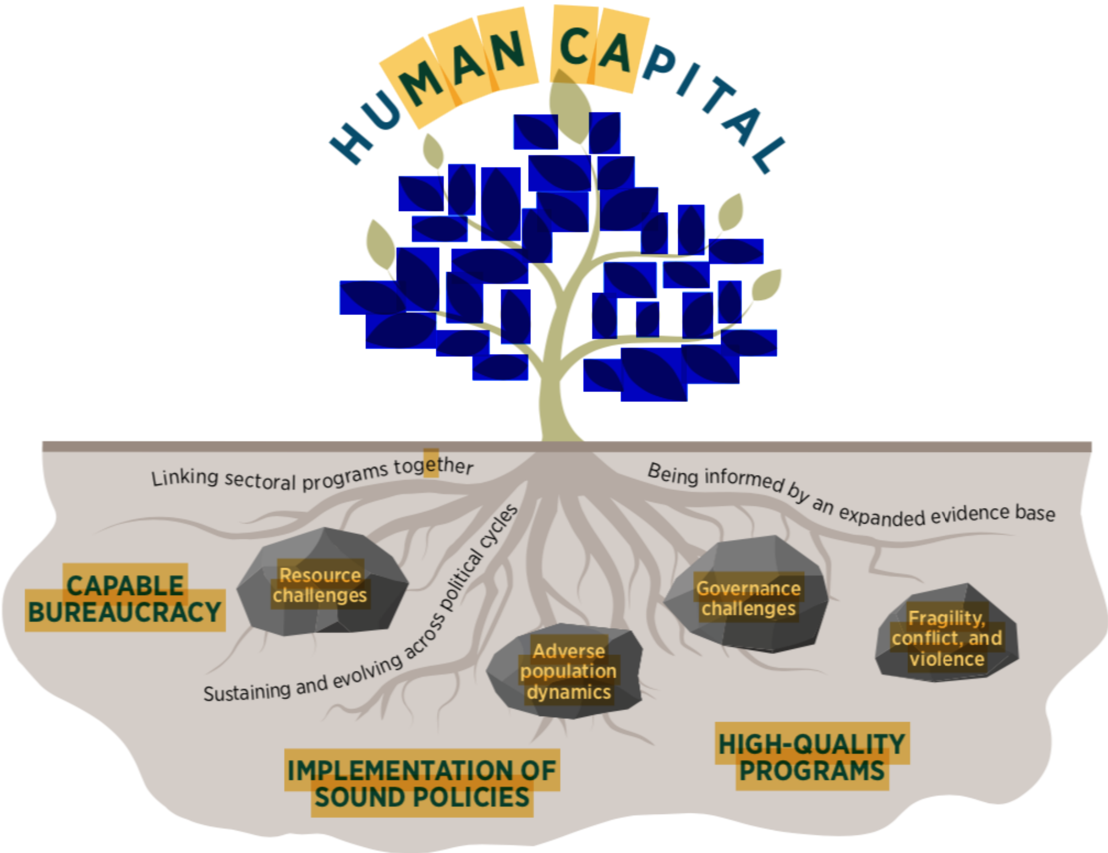
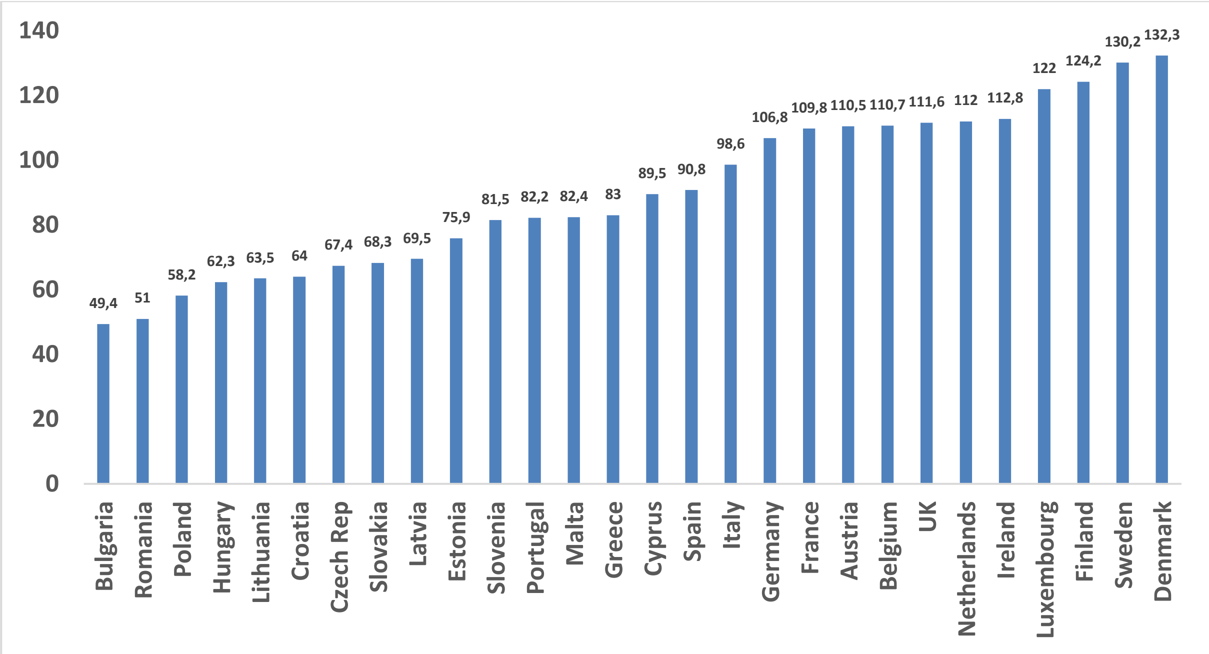


Table a1.4 EU28: educational expenditure as a proportion of GDP and PISA scores

	Education exp.	Education exp.	PISA score*	PISA ranking
	2000	2015	2015/16	2015/16
Estonia	5.34	5.2	524	5
Finland	5.7	7.1	522	8
Ireland	4.1	3.7	509	11
Slovenia	5.8	4.9	509	12
Germany	4.3	4.8	508	13
Netherlands	4.6	5.4	508	14
Denmark	8.1	7.6	504	17
Poland	5	4.8	503	19
Belgium		6.55	502	20
UK	4.1	5.5	499	23
Portugal	5.2	4.9	497	24
France	5.6	5.5	495	25
Sweden	6.8	7.6	495	26
Austria	6.1	5.5	492	27
Spain	4.2	4.3	491	29
Czech Rep	3.7	5.89	490	30
Latvia	5.3	5.3	486	32
Italy	4.3	4.1	485	33
Luxembourg	3.6	3.9	483	34
Croatia	3.8	4.6	475	36
Lithuania	5.8	4.2	475	37
Hungary	4.9	4.6	474	38
Malta		5.3	463	41
Slovakia	3.9	4.7	463	42
Greece	3.2		458	43
Bulgaria	3.4	4	439	45
Cyprus	4.9	6.4	437	46
Romania	2.9	3.1	437	47

* Aggregate PISA scores for mathematics, science and reading
Source Eurostat; OECD

Figure a1.4 EU28 GDP per capita 2017 as percentage of EU average (= 100)



Source Eurostat

Figure a1.5 Changes in subnational government direct investment in the EU28 (2007-2017)

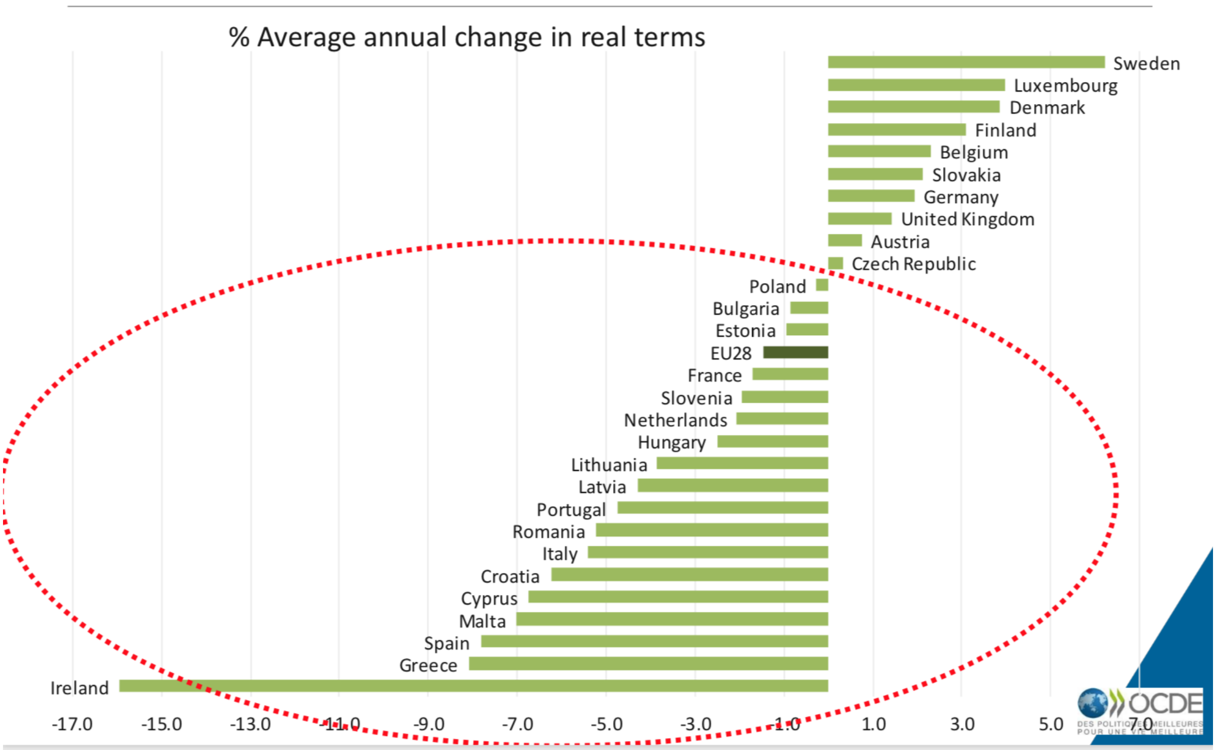
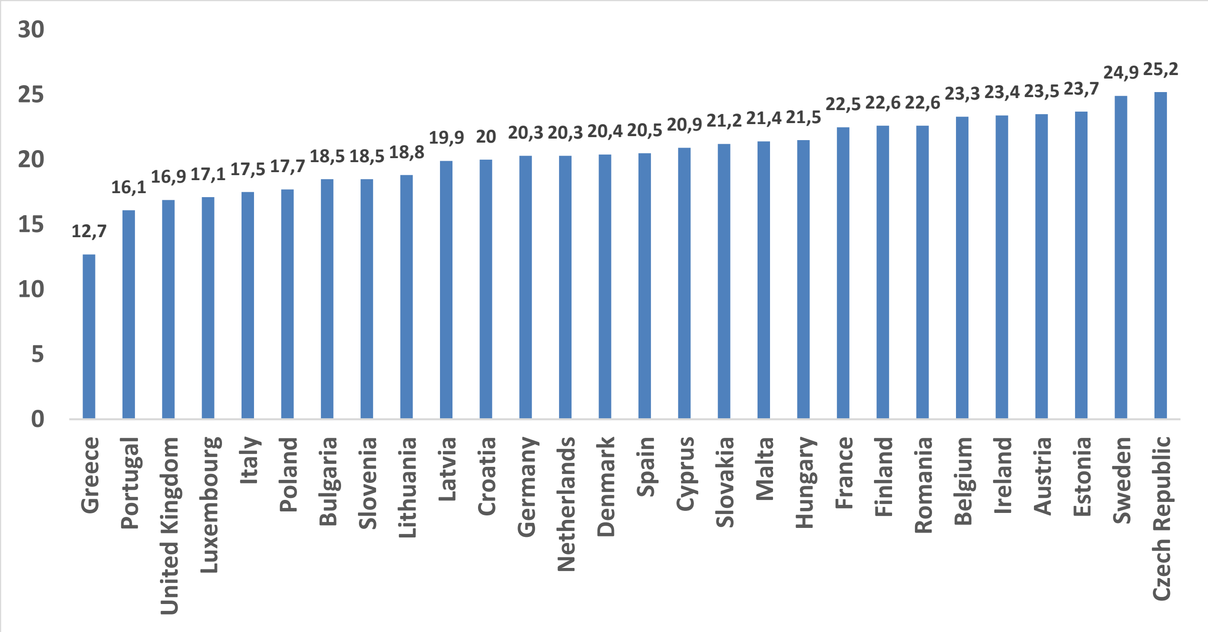
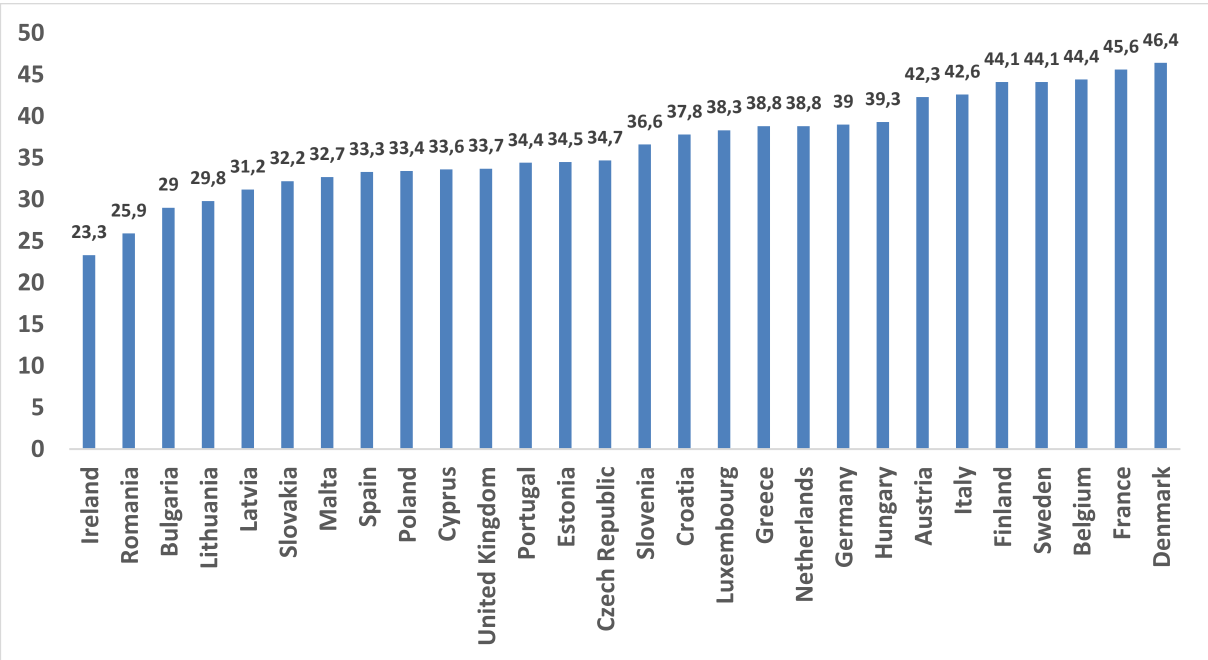


Figure a1.6 EU28 investment ratio* as proportion of GDP 2017



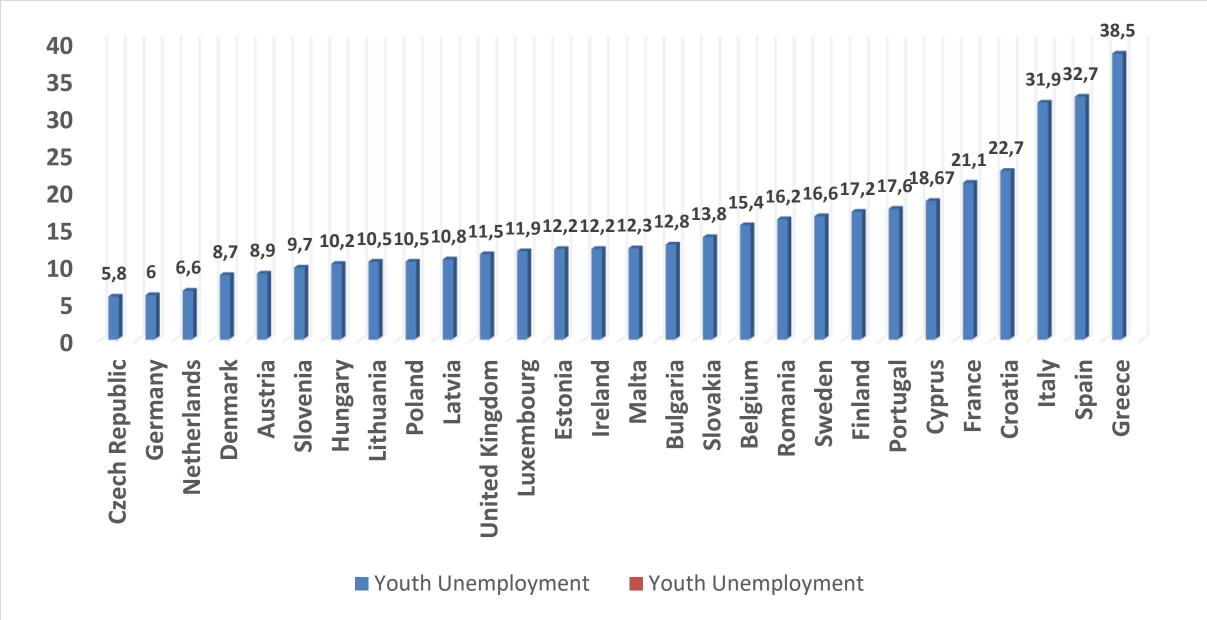
* Gross fixed capital formation.
Source World Bank Open Data

Figure a1.7 EU28 tax ratios as a proportion of GDP 2016



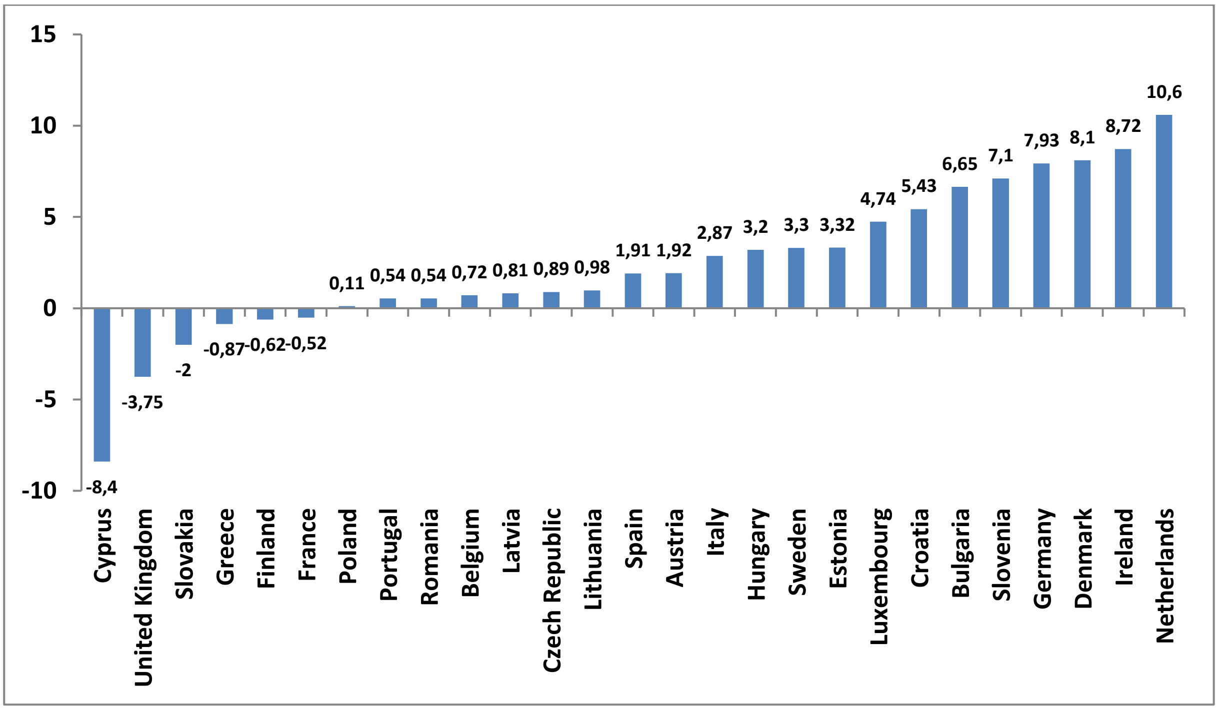
Source European Commission, Taxation Trends in the European Union. Report for 2018; Tax ratios = All tax revenues including social contributions

Figure a1.8 EU28 rate of youth unemployment December 2018



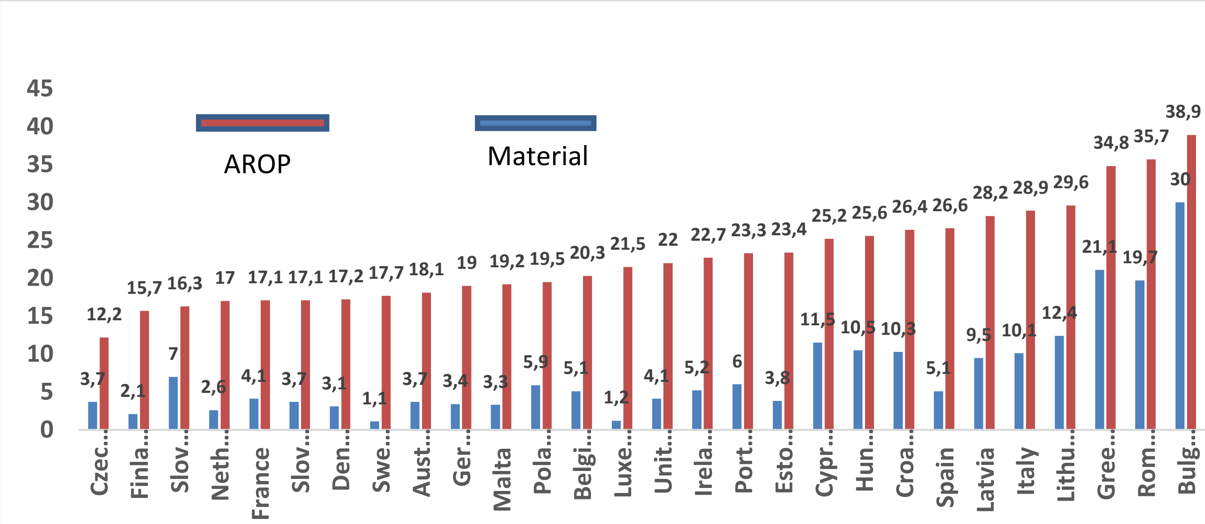
Source Eurostat

Figure a1.9 EU28 current account balances as a percentage of GDP 2017



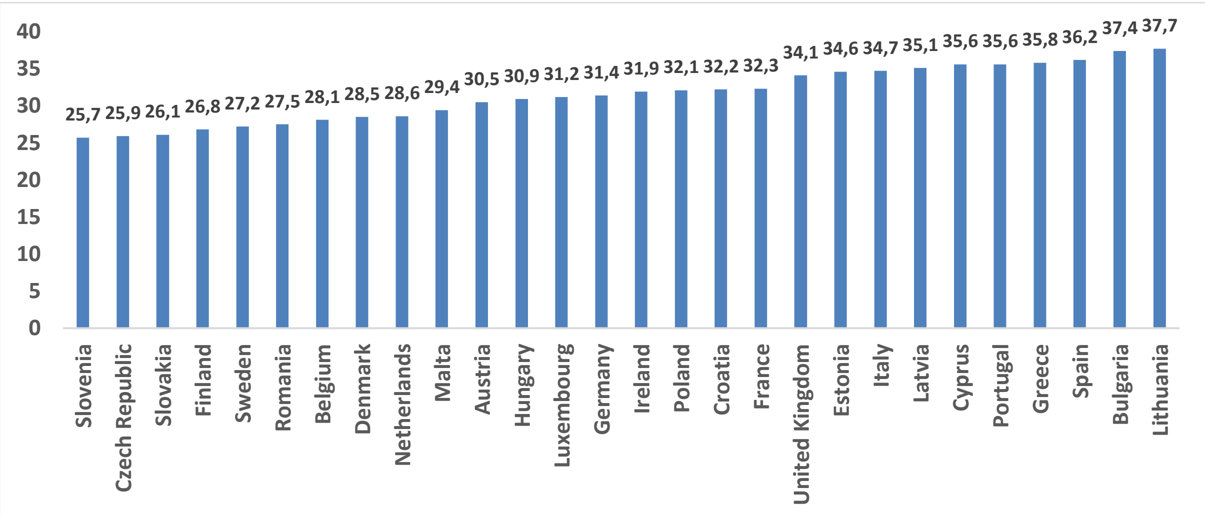
Source World Bank Open Data

Figure a1.10 EU28 percentage of population at risk of poverty & suffering severe material deprivation



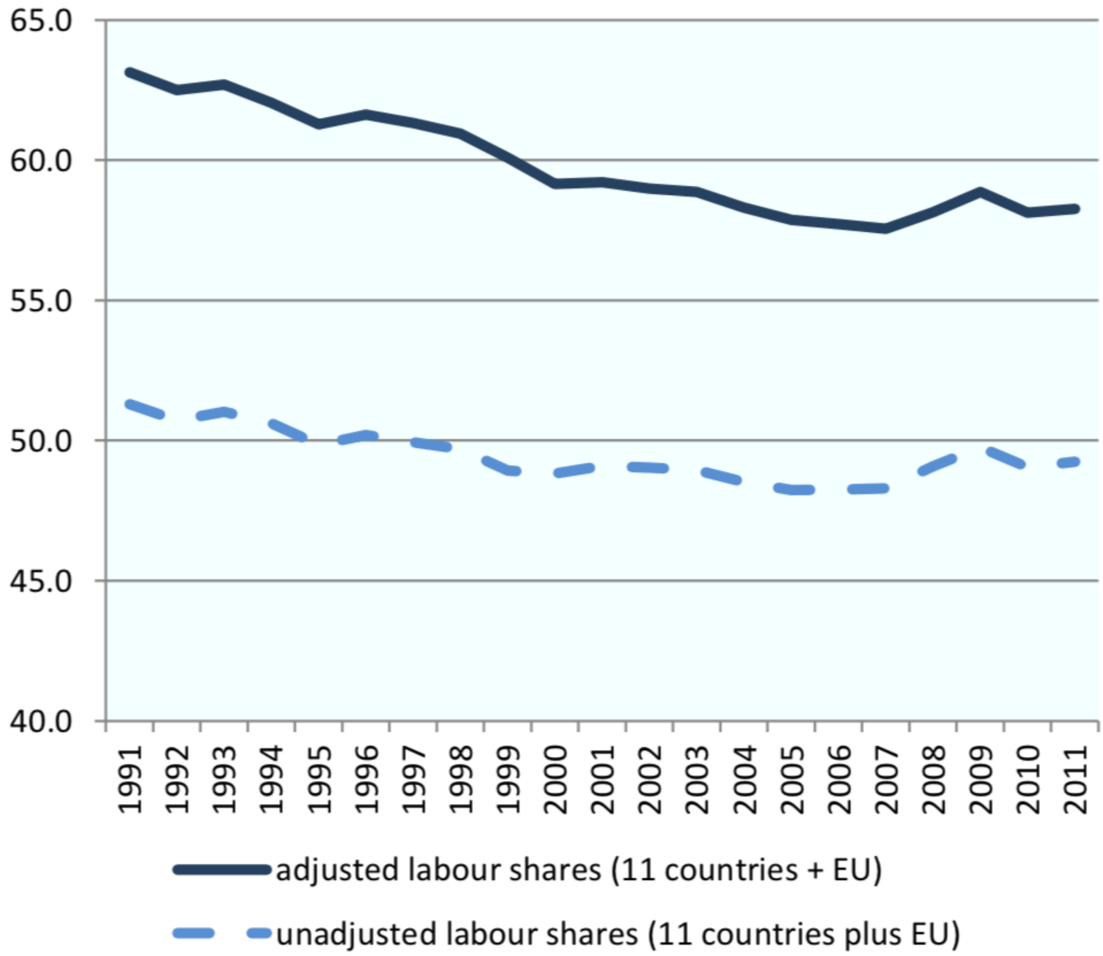
Source Eurostat; Figures for December 2018

Figure a1.11 Net Gini coefficient* EU28



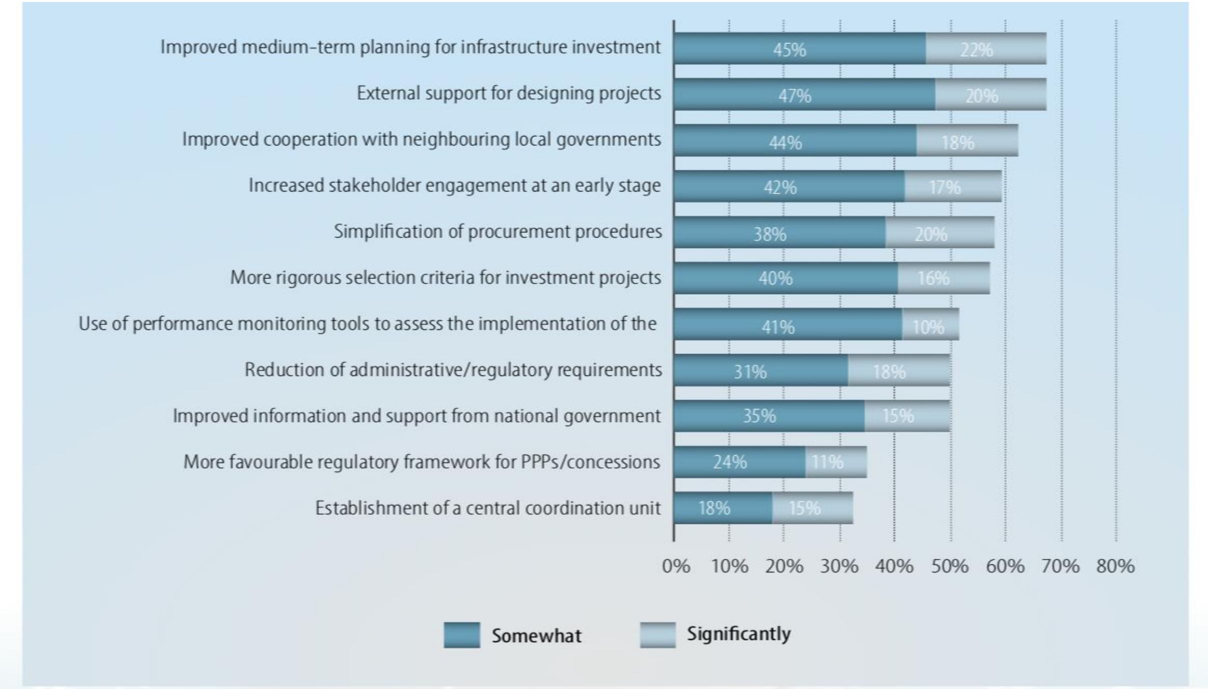
* Gini coefficient of income distribution after taxes and transfers.
Source World Bank; various dates of most recent data publication

Figure a1.12 **The adjusted and unadjusted labour shares in selected G20 countries, estimated by ILO**



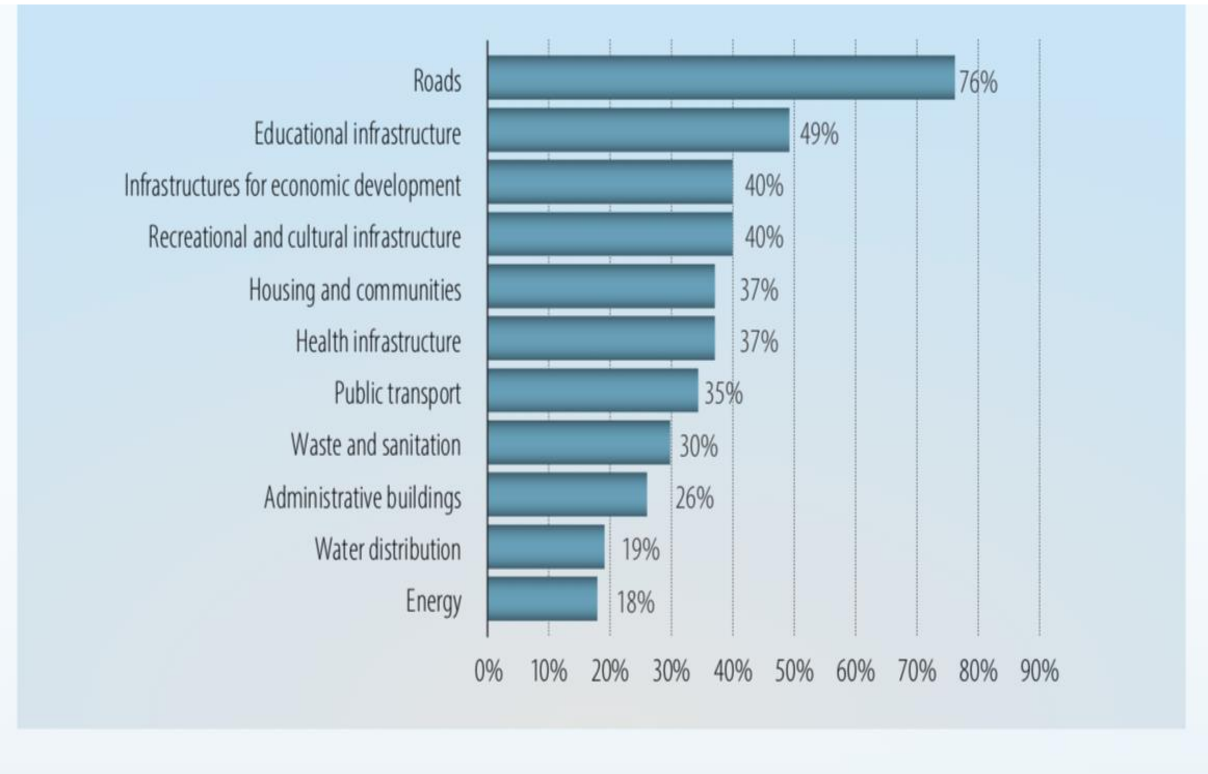
Source OECD (2015)

Figure a1.13 Practices that helped the management of infrastructure investment by SNGs



Source OECD-CoR survey on sub-national governments (2015) and Eurostat in Allain-Dupré et al, forthcoming (2016)

Figure a1.14 Sectors most affected by SNG funding gaps



Source Results of the OECD-CoR survey (2015)

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RE-InVEST - Rebuilding an Inclusive, Value-based Europe of Solidarity and Trust through Social Investments

In 2013, as a response to rising inequalities, poverty and distrust in the EU, the Commission launched a major endeavour to rebalance economic and social policies with the Social Investment Package (SIP). RE-InVEST aims to strengthen the philosophical, institutional and empirical underpinnings of the SIP, based on social investment in human rights and capabilities. Our consortium is embedded in the 'Alliances to Fight Poverty'. We will actively involve European citizens severely affected by the crisis in the co-construction of a more powerful and effective social investment agenda with policy recommendations.

http://www.re-invest.eu/

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